RADA ELECTRONIC INDUSTRIES LTD
Form 20-F
March 30, 2007

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 20-F

[_] REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OR (G) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

OR

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM __________ TO __________

OR

[_] SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

DATE OF EVENT REQUIRING THIS SHELL COMPANY REPORT ....

COMMISSION FILE NUMBER: 0-15375

RADA ELECTRONIC INDUSTRIES LTD.
(Exact Name of Registrant as Specified in Its Charter and Translation of Registrant's Name Into English)

ISRAEL
(Jurisdiction of Incorporation or Organization)

7 GIBOREI ISRAEL STREET, NETANYA 42504, 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, NIS 0.015 PAR VALUE	NASDAQ CAPITAL MARKET

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

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

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

ORDINARY SHARES, PAR VALUE NIS 0.015 PER SHARE...8,728,509

(as of December 31, 2006)

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

Yes [_]   No [X]

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 [X]

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

Yes [X]   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 [X]

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

Item 17 [_]   Item 18 [X]

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 [X]

This Report on Form 20-F is incorporated by reference into our Form F-3 Registration Statements File Nos. 333-127491, 333-117954, 333-115598 and 333-12074, and our Form S-8 Registration Statements File Nos. 333-111437 and 333-12844.

INTRODUCTION

RADA Electronic Industries Ltd. develops, manufactures and sells automated test equipment, avionics products and ground debriefing systems and provides manufacturing services for military and commercial use, mainly in Israel, the U.S. and Europe. We also provide test and repair services using our CATS(TM) testers and test program sets through our Chinese subsidiary. In February 2005, we purchased certain assets and assumed certain liabilities related to the operations of Vectop Ltd., an Israeli company specializing in the design, development, marketing and sale of electro-optic equipment and debriefing systems. Such assets included the know-how, intellectual property and patents that were used by, or connected to Vectop Ltd.'s business. Our products include our Net Centric Digital Recorder and related recording devices, ground information management systems, optronic products, based on technology that we acquired from Vectop Ltd., inertial navigation products and advanced training solutions.

Our shares are traded on the NASDAQ Capital Market, under the symbol "RADA" as used in this annual report, the terms "we," "us" and "our" mean RADA Electronic Industries Ltd. and its subsidiaries, unless otherwise indicated.

We have been using CATS(TM), ACE(TM) and FACE(TM) as trade names. We have acquired the rights to the Israeli trademark VDS(R) and to the U.S. trademark application for the same trademark in connection with the assets we acquired from Vectop Ltd. in February 2005. All other trademarks and trade names appearing in this annual report are owned by their respective holders.

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

In 2006, we received a letter from the NASDAQ Stock Market indicating that our ordinary shares were subject to delisting from the NASDAQ Capital Market as a result of our shares trading below a minimum bid price of $1.00 for thirty consecutive trading days. In order to regain compliance with this requirement our shareholders approved a one share for three shares reverse split on January 29, 2007 and the reverse stock split was effective as of February 14, 2007. As a result of the reverse stock split, we are presently in compliance with the Nasdaq Stock Market Rules. All share and per share amounts in this annual report reflect the reverse stock split.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any previous filing with the Securities and Exchange Commission, you may read the document itself for a complete recitation of its terms.

Except for the historical information contained in this annual report, the statements contained in this annual report are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results. We urge you to consider that statements which use the terms "anticipate," "believe," "do not believe," "expect," "plan," "intend," "estimate," "anticipate" and similar expressions are intended to identify forward-looking statements. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Such forward-looking statements are also included in Item 4 - "Information on the Company" and Item 5 - "Operating and Financial Review and Prospects." Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly release any update or revision to any forward-looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3D. "Key Information - Risk Factors."

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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 derived the following consolidated statements of operations data for the years ended December 31, 2004, 2005 and 2006 and the consolidated balance sheet data as of December 31, 2005 and 2006 from our audited consolidated financial statements included in this annual report. We derived the consolidated statements of operations data for the years ended December 31, 2002 and 2003, and the consolidated balance sheet data as of December 31, 2002, 2003 and 2004 from our audited consolidated financial statements that are not included in this annual report.

	Year Ended December 31,				
	2002	2003	2004	2005	2
	(U.S. dollars in thousands, except share and per sha				
Revenues	$ 10,399	$ 12,315	$ 14,160	$ 13,421	$ 1
Cost of revenues	9,223	9,592	10,287	12,082	1
Gross profit	1,176	2,723	3,873	1,339	
Research and development expenses	122	-	-	-	
Marketing, selling, general and administrative expenses	3,809	2,698	2,854	3,094	
Operating income (loss)	(2,035)	25	1,019	(1,755)	(
Financial income (expenses), net	(364)	708	(248)	(624)	
Other income (expenses), net	(290)	(2)	23	33	
Minority interest in losses (gains) of subsidiary	206	27	28	17	
Net income (loss)	$ (2,483)	$ 758	$ 822	$ (2,329)	$ (
Basic net income (loss) per share*	$ (0.45)	$ 0.12	$ 0.12	$ (0.31)	$
Diluted net income (loss) per share*	$ (0.45)	$ 0.12	$ 0.09	$ (0.31)	$
Weighted average number of shares used to compute basic net income (loss) per share*	5,518	6,170	6,458	7,504	
Weighted average number of shares used to compute diluted net income (loss) per share*	5,518	6,568	7,895	7,504	

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*All share and per share amounts reflect a one share for three shares reverse stock split that was effective February 14, 2007.

	As of December 31,				
	2002	2003	2004	2005	20
	(U.S. dollars in thousands)				
BALANCE SHEET DATA:					
Working capital (deficiency)	$ (8,055)	$ (2,716)	$ 2,265	$ 3,575	$ 3
Total assets	14,607	14,549	18,297	18,890	17
Short-term credits and current maturities of long-term loans	5,697	1,123	14	877	
Long-term debt, net of current maturities ..	-	1,220	-	-	
Convertible note	-	-	2,346	2,560	2
Capital stock	58,893	59,247	64,184	67,016	67
Shareholders' equity	485	2,878	7,232	7,735	6

B. Capitalization and Indebtedness

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

INVESTING IN OUR ORDINARY SHARES INVOLVES A HIGH DEGREE OF RISK AND UNCERTAINTY. YOU SHOULD CAREFULLY CONSIDER THE RISKS AND UNCERTAINTIES DESCRIBED BELOW BEFORE INVESTING IN OUR ORDINARY SHARES. OUR BUSINESS, PROSPECTS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS COULD BE ADVERSELY AFFECTED DUE TO ANY OF THE FOLLOWING RISKS. IN THAT CASE, THE VALUE OF OUR ORDINARY SHARES COULD DECLINE, AND YOU COULD LOSE ALL OR PART OF YOUR INVESTMENT.

RISKS RELATED TO OUR BUSINESS AND OUR INDUSTRY

WE HAVE A HISTORY OF LOSSES, AND MAY NOT BE ABLE TO ACHIEVE OR SUSTAIN PROFITABILITY IN THE FUTURE.

In the year ended December 31, 2006 we recorded a net loss of $2 million. We have incurred losses in three out of the last five years and as of December 31, 2006 our accumulated deficit was $61 million. We may not be able to achieve or sustain profitability in the future.

WE MAY NOT BE ABLE TO SERVICE OUR DEBT, INCLUDING $3 MILLION OF CONVERTIBLE NOTES DUE ON JULY 12, 2007.

Our ability to pay or to refinance our indebtedness, including $3 million of convertible notes due July 12, 2007, will depend upon our future operating performance. Our business may not generate sufficient cash flow from operations and future borrowings may not be available to us in amounts sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. If we are unable to meet our debt service obligations or fund our other liquidity needs, we would attempt to restructure or refinance our indebtedness or seek additional equity capital. It may be challenging for us to accomplish such actions on satisfactory terms.

WE MAY NEED TO RAISE ADDITIONAL CAPITAL IN THE FUTURE, WHICH MAY NOT BE AVAILABLE TO US.

Our working capital requirements and the cash flow from our operating activities are likely to vary greatly from quarter to quarter, depending on the timing of orders and deliveries, the build-up of inventories, and the payment terms offered to our customers. As a consequence of our significant losses, we incurred significant bank debt and sold equity and debt securities in private placements in the years 1997 through 2006. We may need to raise additional funds for a number of uses, including:

- Working capital and operating activities;

- Implementing marketing and sales activities for our products;
- Maintaining and expanding research and development programs;
- Hiring additional qualified personnel; and
- Supporting an increased level of operations.

We may not be able to obtain additional funds on the most favorable terms. If we cannot raise needed funds on favorable terms, we may be required to delay, scale back or eliminate some aspects of our operations and we may not be able to:

- Develop new products;
- Enhance our existing products;
- Remain current with evolving industry standards;
- Fulfill our contractual obligations;
- Take advantage of future opportunities;
- Respond to competitive pressures or unanticipated requirements; or
- Retain our listing on the NASDAQ Capital Market.

If adequate funds are not available to us, our business, and results of operations and financial condition will be materially and adversely affected. Any equity or debt financings may cause dilution to our then-existing shareholders and may increase our financing expenses. If additional funds are raised through the issuance of equity securities, the net tangible book value per share of our ordinary shares would decrease and the percentage ownership of then current shareholders would be diluted.

WE MAY NOT BE ABLE TO IMPLEMENT OUR GROWTH STRATEGY.

In line with our growth strategy, we have entered into teaming agreements and other co-operation agreements with Smiths Aerospace Electronic Systems, or Smiths, and Lockheed Martin Aerospace to increase our penetration into the aviation market. We are currently investing and intend to continue to invest significant resources to develop these relationships. Should our relationships fail to materialize into significant agreements or should we fail to work efficiently with such parties, we may lose sales and marketing opportunities and our business, results of operations and financial condition could be adversely affected.

As part of our growth strategy, we seek to acquire or invest in complementary, including competitive, businesses, products and technologies. We acquired certain assets and assumed certain liabilities related to the operations of Vectop Ltd., or Vectop, in the first quarter of 2005, and are seeking additional potential acquisition candidates. We currently have no commitments or agreements with respect to any future acquisitions or investments and we may not be able to consummate any acquisition or investment. Even if we do acquire or invest in these businesses, products or technology, the process of integrating acquired assets into our operations may result in unforeseen operating difficulties and expenditures and may absorb significant management attention that would otherwise be available for the ongoing development of our business.

In addition, we have limited experience in managing acquisitions and growth. Therefore, the anticipated benefits of any acquisition may not be realized. Furthermore, future acquisitions by us could result in potentially dilutive issuances of our equity securities, the incurrence of debt and contingent liabilities and impairment related to goodwill and other intangible assets, any of which could materially adversely affect our operating results and financial position. Acquisitions also involve other risks, including risks inherent in entering markets in which we have no or limited prior experience and the potential loss of key employees and the risk that we may experience difficulty or delays in obtaining necessary permits.

COMPETITION IN THE MARKET FOR AUTOMATED TEST EQUIPMENT AND AVIONICS EQUIPMENT IS INTENSE AND WE MAY BE UNABLE TO ACHIEVE PROFITABILITY.

The market for our products is highly competitive, and we may not be able to compete effectively in our market. Our principal competitors in the automated test equipment market are Zaban in Israel, and Aerospatiale Avionique and Avtron abroad. Our principal competitors in the avionics market are Harris, Rockwell Collins, Honeywell, Elbit Systems Ltd., or Elbit, Israel Aircraft Industries Ltd., or IAI, R.S.L. Ltd., TEAC and Elisra Systems Ltd. We expect to continue to face competition from these and other competitors. Most, if not all, of our competitors are far larger, have substantially greater resources including financial, technological, marketing and distribution capabilities, and enjoy greater market recognition than we have. These competitors may be able to achieve greater economies of scale and may be less vulnerable to price competition than us. We may not be able to offer our products as part of integrated systems to the same extent as our competitors or successfully develop or introduce new products that are more cost effective or offer better performance than those of our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.

OUR INITIATIVE OF PROVIDING MANUFACTURING SERVICES MAY NOT SUCCEED, AND AS A RESULT, WE MAY BE UNABLE TO ACHIEVE PROFITABILITY IN OUR BEIT-SHE'AN PRODUCTION FACILITY AND MAY BE FORCED TO SHUT DOWN ITS OPERATIONS.

In June 2000, we began to provide manufacturing services to original equipment manufacturers in Israel and the United States, using the manufacturing capabilities of our Beit-She'an plant. The market for our manufacturing services is highly competitive and we may not be able to compete effectively in this market. The cost of labor and the efficiency of the production equipment and production processes are crucial to our success in this market. Consequently, should we fail to maintain low labor costs, enhance our production equipment and develop new and more efficient production methods, we may have to shut down the operations of our Beit-She'an plant, which may harm our competitiveness and could adversely affect our business, results of operations and financial condition.

REDUCTION IN MILITARY BUDGETS WORLDWIDE MAY CAUSE A REDUCTION IN OUR REVENUES, WHICH WOULD ADVERSELY AFFECT OUR BUSINESS, OPERATING RESULTS AND FINANCIAL CONDITION.

A significant portion of our revenues is derived from the sale of products with military applications. These revenues, on a consolidated basis, totaled approximately $11.6 million, or 89% of revenues in 2006, $11.8 million, or 88 % of revenues in 2005, and $11.8 million, or 83% of revenues in 2004. The military budgets of a number of countries may be reduced in the future. Declines in military budgets may result in reduced demand for our products and manufacturing services. This would result in reduction in our core business' revenues and adversely affect our business, results of operations and financial condition.

SALES OF OUR PRODUCTS ARE SUBJECT TO GOVERNMENTAL PROCUREMENT PROCEDURES AND PRACTICES; TERMINATION, REDUCTION OR MODIFICATION OF CONTRACTS WITH OUR CUSTOMERS, AND ESPECIALLY WITH THE GOVERNMENT OF ISRAEL, OR A SUBSTANTIAL DECREASE IN OUR CUSTOMERS' BUDGETS MAY ADVERSELY AFFECT OUR BUSINESS, OPERATING RESULTS AND FINANCIAL CONDITION.

Our military aviation products are sold primarily to government agencies and authorities and government-owned companies, many of which have complex and time-consuming procurement procedures. A long period of time often elapses from the time we begin marketing a product until we actually sell that product to a particular customer. In addition, our sales to government agencies, authorities and companies are directly affected by these customers' budgetary constraints and the priority given in their budgets to the procurement of our products.

Further, our business with the State of Israel and other governmental entities is, in general, subject to delays in funding and performance of contracts and the termination of contracts or subcontracts for convenience, among others. The termination, reduction or modification of our contracts or subcontracts with the Government of Israel in the event of change in requirements, policies or budgetary constraints would have an adverse effect on our business, operating results and financial condition.

IF WE DO NOT RECEIVE THE GOVERNMENTAL APPROVALS NECESSARY FOR THE EXPORT OF OUR PRODUCTS, OUR REVENUES MAY DECREASE. SIMILARLY IF OUR SUPPLIERS AND PARTNERS DO NOT RECEIVE THEIR GOVERNMENT APPROVALS NECESSARY TO EXPORT THEIR PRODUCTS OR DESIGNS TO US, OUR REVENUES MIGHT DECREASE AND WE MAY FAIL TO IMPLEMENT OUR GROWTH STRATEGY.

Under Israeli law, the export of certain of our products and know-how is subject to approval by the Israeli Ministry of Defense. To initiate sales proposals with regard to exports of our products and know-how and to export such products or know-how, we must obtain permits from the Ministry of Defense. We may not be able to receive in a timely manner all the required permits for which we may apply in the future.

Similarly, under foreign laws the export of certain military products, technical designs and spare parts require the prior approval of, or export license from, such foreign governments. In order to maintain our third party production, certain co-development activities and procurements required for the performance of certain contracts, we must receive detailed technical designs, products or products' parts samples from our strategic partners or suppliers. We may not be able to receive all the required permits and/or licenses in a timely manner. Consequently, our revenues may decrease and we may fail to implement our growth strategy.

WE DEPEND ON SALES TO KEY CUSTOMERS AND THE LOSS OF ONE OR MORE OF OUR KEY CUSTOMERS WOULD RESULT IN A LOSS OF A SIGNIFICANT AMOUNT OF OUR REVENUES.

A significant portion of our revenues is derived from a small number of customers. Our major customers during the three years ended December 31, 2006 were as follows:

	Percentage of Revenues		
	2004	2005	2006
Smiths Electronic Systems .	5%	21%	38%
The Boeing Company	10%	3%	-
Israeli Ministry of Defense	19%	12%	5%
Israel Aviation Industries	6%	14%	20%
Portuguese Air Force	17%	-	2%
U.S. Navy	11%	-	-

Lockheed Martin	5%	12%	9%
Hindustan Aeronautics	-	5%	3%

We anticipate that a significant portion of our future revenues will continue to be derived from sales to a small number of customers. If our principal customers do not continue to purchase products from us at current levels or if such customers are not retained and we are not able to derive sufficient revenues from sales to new customers to compensate for their loss, our revenues would be reduced and adversely affect our business, financial condition and results of operations.

WE DEPEND ON A LIMITED NUMBER OF SUPPLIERS OF COMPONENTS FOR OUR PRODUCTS AND IF WE ARE UNABLE TO OBTAIN THESE COMPONENTS WHEN NEEDED, WE WOULD EXPERIENCE DELAYS IN MANUFACTURING OUR PRODUCTS AND OUR FINANCIAL RESULTS COULD BE ADVERSELY AFFECTED.

We acquire most of the components for the manufacturing of our products from a limited number of suppliers and subcontractors, most of whom are located in Israel and the United States. Certain of these suppliers are currently the sole source of one or more components upon which we are dependent. Suppliers of some of the components for manufacturing require us to place orders with significant lead-time to assure supply in accordance with our manufacturing requirements. Inadequacy of operating funds may cause us to delays placement of such orders and may result in delays in supply. Delays in supply may significantly hurt our ability to fulfill our contractual obligations and may significantly hurt our business and result of operations. We may not be able to continue to obtain such components from these suppliers on satisfactory commercial terms. Temporary disruptions of our manufacturing operations would ensue if we were required to obtain components from alternative sources, which may have an adverse effect on our financial results.

WE RELY ON THE AIRLINE INDUSTRY AND THE CONTINUED FINANCIAL CRISES IN THIS INDUSTRY ADVERSELY AFFECTS OUR SALES.

The airline industry is an important market for our automated test equipment products and product support services. Our ability to achieve growth and profitability in this market depends in great measure on the economic condition of the commercial aviation industry. Since 2001, and especially following the tragic events of September 11, 2001, the airline industry has suffered from economic decline that caused the bankruptcy of several airlines and imposed financial constraints on the entire industry. As a result of these conditions, the sales of our automated test equipment products have materially decreased. The continuance of the crisis in the commercial aviation industry will adversely affect our business, financial condition and results of operations.

RAPID TECHNOLOGICAL CHANGES MAY ADVERSELY AFFECT THE MARKET ACCEPTANCE OF OUR PRODUCTS.

The avionics market in which we compete is subject to technological changes, introduction of new products, change in customer demands and evolving industry standards. Our future success will depend upon our ability to keep pace with technological developments and to timely address the increasingly sophisticated needs of our customers by supporting existing and new technologies and by developing and introducing enhancements to our current products and new products. We may not be successful in developing and marketing enhancements to our products that will respond to technological change, evolving industry standards or customer requirements. In addition, we may experience difficulties that could delay or prevent the successful development, introduction and sale of such enhancements, and such enhancements may not adequately meet the requirements of the market and may not achieve any significant degrees of market acceptance. If release dates of our new products or enhancements are delayed or, if when released, they fail to achieve market acceptance, our business, operating results and financial condition would be materially adversely affected.

WE MAY ENCOUNTER DIFFICULTIES WITH OUR INTERNATIONAL OPERATIONS AND SALES.

While our principal executive offices are located in Israel, exports accounted for 67% of our sales in 2006, 59% of our sales in 2005 and 65% of our sales in 2004. This subjects us to many risks inherent in engaging in export international business, including:

- Limitations and disruptions resulting from the imposition of government controls;
- Changes in regulatory requirements;
- Export license requirements;
- Economic or political instability;
- Trade restrictions;
- Changes in tariffs;
- Currency fluctuations;
- Longer receivable collection periods and greater difficulty in accounts receivable collection;
- Greater difficulty in safeguarding intellectual property;
- Difficulties in managing overseas subsidiaries and international operations; and
- Potential adverse tax consequences.

We may not be able to sustain or increase revenues from international operations and may encounter significant difficulties in connection with the sale of our products in international markets. Any of those events will have a material adverse affect on our business, operating results and financial condition.

CURRENCY EXCHANGE RATE FLUCTUATIONS IN THE WORLD MARKETS IN WHICH WE CONDUCT BUSINESS COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

We may be adversely affected by fluctuations in currency exchange rates. While our revenues are generally denominated in U.S. dollars, a significant portion of our expenses is incurred in NIS. We do not currently engage in any currency hedging transactions intended to reduce the effect of fluctuations in foreign currency exchange rates on our results of operations. If we were to determine that it was in our best interests to enter into any hedging transactions in the future, we may not be able to do so. Furthermore, such transactions, if entered into, may not materially reduce the effect of fluctuations in foreign currency exchange rates on our results of operations. In addition, if for any reason exchange or price controls or other restrictions on the conversion of foreign currencies into NIS were imposed, our business could be adversely affected. In the future, such fluctuations may have a material adverse effect on revenues from international sales, operating expenses and consequently, on our business, operating results and financial condition.

WE ARE DEPENDENT ON OUR SENIOR MANAGEMENT AND KEY PERSONNEL, IN PARTICULAR HERZLE BODINGER, OUR CHAIRMAN AND CHIEF EXECUTIVE OFFICER, WHOSE LOSS COULD ADVERSELY AFFECT OUR BUSINESS.

Our future success depends in large part on the continued services of our senior management and key personnel. In particular, we are dependent on the services of Herzle Bodinger, Our chairman and chief executive officer. We do not carry key person life insurance on our senior management or key personnel. Any loss of the services of Herzle Bodinger, other members of senior management or other key personnel could negatively and materially effect our business.

OUR PROPRIETARY TECHNOLOGY IS DIFFICULT TO PROTECT AND UNAUTHORIZED USE OF OUR PROPRIETARY TECHNOLOGY BY THIRD PARTIES MAY IMPAIR OUR ABILITY TO COMPETE EFFECTIVELY.

Our success and ability to compete largely depends upon protecting our proprietary technology. We rely on a combination of trade secrets, copyright law and confidentiality, non-disclosure and assignment-of-inventions agreements to protect our proprietary technology. Except for a patent that relates to our ACE(TM) system, we do not have any patents.

OUR PRODUCTS MAY INFRINGE ON THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS.

Third parties may assert infringement claims against us or claims that we have violated a patent or infringed on a copyright, trademark or other proprietary right belonging to them. In addition, any infringement claim, even one without merit, could result in the expenditure of significant financial and managerial resources to defend.

THE STATUS OF OUR CHINESE SUBSIDIARY AND ITS JOINT VENTURE WITH BEIJING TIANZU FORESTRY COMPANY IS UNCERTAIN AND WE MAY BE REQUIRED TO INITIATE LITIGATION IN ORDER TO ENFORCE OUR RIGHTS.

Beijing Huarui Aircraft Components Maintenance and Services Co., Ltd. or CACS, our Chinese subsidiary, conducts its business in an approximately 16,000 square foot facility in Beijing that includes offices and test and repair facilities. The land for this facility was leased by Beijing Tianzu Forestry Company or Tianzu, the minority shareholder in CACS, from the Chinese government for 30 years. Under a joint venture agreement, and in consideration for its equity investment in CACS, Tianzu granted CACS usage rights in the land, constructed the buildings and granted CACS the ownership of these buildings. However, the transfer of the title to the land and the buildings has not been completed. Although Tianzu is legally obligated to complete such transfer of title to the land and the buildings, such transfer may not be completed and we may be required to initiate litigation in order to enforce our rights to receive title to the land and buildings.

COMPLIANCE WITH CHANGING REGULATION OF CORPORATE GOVERNANCE AND PUBLIC DISCLOSURE MAY RESULT IN ADDITIONAL EXPENSES.

As a result of certain corporate governance scandals and the legislative and litigation environment resulting from those scandals, the costs of being a public company in general have increased in recent years. The Sarbanes-Oxley Act of 2002 requires changes in some of our corporate governance and securities disclosure or compliance practices. We expect that the on-going implementation of these regulations will further increase our legal compliance costs and will make some activities more time consuming. We are presently evaluating and monitoring regulatory developments and cannot estimate the magnitude of additional costs we may incur as a result of such developments. Implementing Section 404 of the Sarbanes-Oxley Act of 2002, which governs internal controls and procedures for financial reporting, will require expenditure of significant management time and financial resources to comply with the applicable requirements. This and other proposed legislation may increase the fees of our professional advisors and our insurance premiums.

RISK FACTORS RELATED TO OUR ORDINARY SHARES

OUR SHARE PRICE HAS BEEN VOLATILE IN THE PAST AND MAY DECLINE IN THE FUTURE.

Our ordinary shares have experienced significant market price and volume fluctuations in the past and may experience significant market price and volume fluctuations in the future in response to factors such as the following, some of which are beyond our control:

- Quarterly variations in our operating results;
- Operating results that vary from the expectations of securities analysts and investors;
- Changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- Announcements of technological innovations or new products by us or our competitors;
- Announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- Changes in the status of our intellectual property rights;
- Announcements by third parties of significant claims or proceedings against us;
- Additions or departures of key personnel;
- Future sales of our ordinary shares;
- Delisting of our shares from the NASDAQ Capital Market; and
- Stock market price and volume fluctuations.

Domestic and international stock markets often experience extreme price and volume fluctuations. Market fluctuations, as well as general political and economic conditions, such as a recession or interest rate or currency rate fluctuations or political events or hostilities in or surrounding Israel, could adversely affect the market price of our ordinary shares.

In the past, securities class action litigation has often been brought against companies following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources both of which could have a material adverse effect on our business and results of operations.

SUBSTANTIAL FUTURE SALES OF OUR ORDINARY SHARES MAY DEPRESS OUR SHARE PRICE.

If our shareholders sell substantial amounts of our ordinary shares, including shares registered under effective registration statements and shares issuable upon the exercise of outstanding warrants, or convertible notes, or if the perception exists that our shareholders may sell a substantial number of our ordinary shares, the market price of our ordinary shares may fall. Any substantial sales of our shares in the public market also might make it more difficult for us to sell equity or equity related securities in the future at a time, in a place and on terms we deem appropriate.

WE DO NOT INTEND TO PAY DIVIDENDS.

We have never declared or paid cash dividends on our ordinary shares and do not expect to do so in the foreseeable future. The declaration of dividends is subject to the discretion of our board of directors and will depend on various factors, including our operating results, financial condition, future prospects and any other factors deemed relevant by our board of directors. You should not rely on an investment in our company if you require dividend income from your investment in our company. The success of your investment will likely depend entirely upon any future appreciation of the market price of our ordinary shares, which is uncertain and unpredictable. There is no guarantee that our ordinary shares will appreciate in value or even maintain the price at which you purchased your ordinary shares.

RISKS RELATING TO OUR LOCATION IN ISRAEL

CONDUCTING BUSINESS IN ISRAEL ENTAILS SPECIAL RISKS.

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

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, there has been an increase in unrest and terrorist activity in Israel, which began in September 2000 and which has continued with varying levels of severity through 2006. In July 2006, an armed conflict began between Israel and Hezbollah forces in Lebanon, which involved rocket attacks on populated areas in the northern parts of Israel. On August 14, 2006, a cease-fire between Hezbollah and Israel took effect. This situation has had an adverse effect on Israel's economy, primarily in the geographical areas directly harmed by this conflict. Any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development or 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 we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

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

THE ECONOMIC CONDITIONS IN ISRAEL HAVE NOT BEEN STABLE IN RECENT YEARS.

In recent years Israel has been going through a period of recession in economic activity, resulting in low growth rates and growing unemployment. Although economic activity in Israel has improved recently, our operations could be adversely affected if the economic conditions in Israel begin to deteriorate once again.

WE MAY BE ADVERSELY AFFECTED IF THE RATE OF INFLATION IN ISRAEL EXCEEDS THE RATE OF DEVALUATION OF THE NIS AGAINST THE U.S. DOLLAR.

In 2006, approximately 31% of our expenses were in U.S. dollars or U.S. dollar-linked NIS, in 2005 approximately 38% of our expenses were in U.S. dollars or U.S. dollar-linked NIS and in 2004 approximately 34% of our expenses were in U.S. dollars or U.S. dollar-linked NIS. In each of these years, virtually all our remaining expenses were in unlinked NIS. Our expenses that are denominated in U.S. dollars or paid in Israeli currency linked to the U.S. dollar-NIS exchange rate are influenced by the extent to which any inflation in Israel is not offset (or is offset on a lagging basis) by the devaluation of the NIS in relation to the U.S. dollar. In 2004 and 2005, the rate of inflation was 1.2% and 2.4%, respectively and in 2006 the rate deflation was 0.1% and the NIS was reevaluated against the dollar. These changes, as well as the recent world-wide devaluation of the U.S. dollar, have affected our operations, financial condition and results of operations by decreasing the NIS equivalents of our U.S. denominated revenues and increasing the U.S. dollar equivalents of our NIS denominated expenses. We may be adversely affected in the future if the rate of inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of this devaluation lags behind increases in inflation in Israel.

SERVICE AND ENFORCEMENT OF LEGAL PROCESS ON US AND OUR DIRECTORS AND OFFICERS MAY BE DIFFICULT TO OBTAIN.

Service of process upon our directors and officers and the Israeli experts named herein, most of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, since substantially all of our assets, most of our directors and officers and the Israeli experts named in this annual report are located outside the United States, any judgment obtained in the United States against us or these individuals or entities may not be collectible within the United States.

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

PROVISIONS OF ISRAELI LAW MAY DELAY, PREVENT OR MAKE THE ACQUISITION OF OUR COMPANY DIFFICULT, WHICH COULD PREVENT A CHANGE OF CONTROL AND THEREFORE DEPRESS THE PRICE OF OUR SHARES.

Provisions of Israeli corporate and tax law may have the effect of delaying, preventing or making more difficult a merger with, or other acquisition of, us. This could cause our ordinary shares to trade at prices below the price for which third parties might be willing to pay to gain control of us. Third parties who are otherwise willing to pay a premium over prevailing market prices to gain control of us may be unable or unwilling to do so because of these provisions of Israeli law.

YOUR RIGHTS AND RESPONSIBILITIES AS A SHAREHOLDER WILL BE GOVERNED BY ISRAELI LAW AND DIFFER IN SOME RESPECTS FROM THE RIGHTS AND RESPONSIBILITIES OF SHAREHOLDERS UNDER U.S. LAW.

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

AS A FOREIGN PRIVATE ISSUER WHOSE SHARES ARE LISTED ON THE NASDAQ CAPITAL MARKET, WE MAY FOLLOW CERTAIN HOME COUNTRY CORPORATE GOVERNANCE PRACTICES INSTEAD OF CERTAIN NASDAQ REQUIREMENTS.

As a foreign private issuer whose shares are listed on the NASDAQ Capital Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules, including the composition of our board of directors, director nomination procedure, compensation of officers and quorum at shareholders meetings. In addition, we may follow Israeli law instead of the NASDAQ Marketplace Rules that require that we obtain shareholder approval for certain dilutive events, such as for the establishment or amendment of certain equity based compensation plans, an issuance that will result in a change of control of our company, certain transactions other than a public offering involving issuances of a 19.9% or more interest in our company and certain acquisitions of the stock or assets of another company.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

We were incorporated under the laws of the State of Israel on December 8, 1970. We are a public limited liability company under the Israeli Companies Law 1999-5759, or the Israeli Companies Law, and operate under this law and associated legislation. Our registered offices and principal place of business are located at 7 Giborei Israel Street, Netanya 42504, Israel, and our telephone number is 972-9-892-1111. Our address on the internet is www.rada.com. The information on our website is not incorporated by reference into this annual report.

We develop, manufacture and sell automated test equipment, avionics products and ground debriefing systems and provide manufacturing services for military and commercial use, mainly in Israel, the U.S. and Europe. We also provide test and repair services using our CATS(TM) testers and test program sets through our Chinese subsidiary. Our U.S.-based subsidiaries have been inactive since January 1, 2002.

In April 1985, we completed an initial public offering. Our ordinary shares are traded on the NASDAQ National Market from our initial public offering in 1985 until June 10, 2002 when the listing of our ordinary shares was transferred to the NASDAQ Capital Market. We are listed under the symbol "RADA."

In February 2005, we purchased certain assets and assumed certain liabilities related to the operations of Vectop, an Israeli company specializing in the design, development, marketing and sale of electro-optic equipment and debriefing systems. Such assets included the know-how, intellectual property and patents that were used by, or connected to Vectop's business, as well as full access to customer lists related to the products acquired.

Our capital expenditures for the years ended December 31, 2004, 2005 and 2006 were approximately $349,000, $411,000 and $236,000, respectively. These expenditures were principally for machinery equipment and office furniture and equipment.

B. BUSINESS OVERVIEW

INDUSTRY OVERVIEW

Our activity is focused on the market for defense electronics products. This market has been growing in recent years and is currently a large part of the defense business. Two contradictory forces control the defense electronics market. On the one hand, new military aircraft are equipped with significantly more avionics systems than they used to carry ten to twenty years ago. In addition, the increasing usage of advanced avionics in modern aircraft, including upgrades of existing technology and growing number of unmanned aerial vehicles, or UAVs, has provided significant growth to the market. On the other hand, the significant reduction in the price of electronic systems is shrinking the dollar value of the market.

Advanced defense electronics systems are, typically, derivatives or enhancements of consumer electronic systems. Most of the defense electronics systems are built for commercial components and even sub-systems, a fact that reduces the overall price and, at the same time, generates complex obsolescence issues.

Customers for defense electronics products in the aerospace field are either governments or major integrators. Doing business with these customers is complex, has a long sales cycle and requires long term commitments for future support of delivered hardware. Production batches of these products are, usually small, especially in the retrofit market.

Suppliers of defense electronic systems are either providers of sub-systems to major integrators or providers of integrated systems to the aircraft industry or to air forces. These companies are typically very large and have diversified product offerings.

New products in the defense electronic market are usually developed utilizing internal research and development funds of customers and are tailored to specific customers' needs. In many cases, the customer who pays for the design and adaptation limits the use of intellectual property that was funded by it for other applications, due to either financial or security reasons.

PRODUCTS AND SERVICES

We provide integrated avionic solutions. Our aim is to provide not only state of the art products but also comprehensive end- to- end solutions for one or more avionic systems. The first integrated system that we provided was for the A-4 avionics upgrade program of the Israeli Air Force, or IAF. This program was the first comprehensive and complete avionics system to be provided entirely by us. During 2004, we increased our involvement and development efforts in the area of unmanned aircraft vehicles. Currently we have four new product lines:

- Net-Centric Digital Recorder and related recording devices;
- Ground information management systems that support our recording products and provide advanced data management capabilities;
- Optronic products based on technology we acquired as part of the Vectop transaction; and
- Inertial navigation products based on ring laser gyros, or RLG, fiber optic gyros, or FOG, and micro-electro mechanical sensors, or MEMS.

In addition, we continue to sell and support our traditional products including:

- Advanced training solutions;
- Integrated trainer aircraft avionics packages;
- Flight data recorders and supporting ground analysis;
- Unmanned aerial vehicle avionics; and
- Automatic testing solutions.

We also provide manufacturing services to original equipment manufacturers in Israel and in the United States, using the manufacturing capabilities of our

Beit She'an plant. We offer production of turnkey solutions, in "build to print" or "build to specification" modes. To date, we have provided manufacturing services to, among others, Smiths, Israel Aircraft Industries, or IAI, and RAFAEL Armament Development Authority Ltd., or RAFAEL. Our China-based subsidiary provides test and repair services using our CATS(TM) testers and test program sets.

NET CENTRIC DIGITAL RECORDER - NCDR

Recent developments in digital video recording systems and the significant reduction in size and cost of solid state memories have turned solid state digital video recording systems into the de-facto standard solution for airborne applications. These systems have begun penetrating the aviation industry in new aircraft such as the F-16I, as well as in the retrofit market. Identifying this trend, we developed the Net Centric Digital Recorder, or NCDR with the view of capturing sales from: (i) new aircraft that will be delivered with digital recorders; (ii) the retrofit market for airborne video tape recorders; and (iii) the integration of various additional applications into the NCDR, making it an airborne server.

The NCDR, together with our ground debriefing system, provides advanced debriefing at an affordable price. We have identified a growing need for digital video replacement of aging analog airborne video tape recorders, or VTR. Approximately 15,000 VTRs are installed on board fighter aircraft today and we have initiated a world-wide marketing effort to promote the replacement of these aging VTRs with our new NCDR. This marketing activity has been successful in several programs around the world, especially in our strategic markets. We were awarded the U.S. Navy T-45 advanced trainer digital recorder and processor program and we are making final deliveries of our NCDR to the Chilean Air Force for its F-16 fleet. In 2006, we were chosen by Lockheed Martin to provide the NCDR for all LM F-16 aircraft. We won a similar NCDR program for an Indian Navy aircraft. The NCDR is fully qualified and is continuously being demonstrated to various potential customers. We currently market the NCDR jointly with Smiths, utilizing Smiths' broader access to the market, especially in the U.S.

Additional applications are being developed and integrated into the NCDR in order to provide an integrated airborne data server. These applications include embedding data transfer capability to the system enabling the NCDR not only to record during flight but also to provide data to the aircraft before flight, and the integration of ground collision warning based on digital terrain data stored in the NCDR memory.

GROUND INFORMATION MANAGEMENT SYSTEMS

Since 1999, we have offered operational ground debriefing stations complementing our airborne systems. The operational ground debriefing station is a PC-based application operating in a Windows NT/2000/XP(R) environment. The solution, provides a state-of-the-art debriefing environment, fully capitalizing on all available digital and video information in a highly synchronized presentation. Further capitalizing on current day technology, individual stations have a networking capability, providing data sharing, as well as cross-unit and inter-air force debriefing.

The IAF and two other air forces have purchased ground debriefing systems for their F-16 A/B, F-5 and A-4 fleets.

As part of the Peace Marble, or PM-V Program, with Lockheed Martin

Aerospace, we developed the next generation of our ground information management system by advancing it to the digital video era. This modification has resulted in significant growth in the system's capability as well as establishing our system as a major and central device in the day- to-day operation of air force squadrons.

As of December 31, 2006, we have delivered 22 systems to the PM-V Program as well as two additional debriefing systems to Lockheed Martin Aerospace for use in integration and flight-testing. We are in the final stages of a completing a digital debriefing system for the new F-16s purchased by the Chilean Air Force. As an extension of the development work completed as part of the PM-V Program, we are supplying the Chilean Air Force with a digital video recorder for each of their F-16 aircraft as well as an advanced digital video ground debriefing station. This station will be linked to a F-5 ground debriefing station we previously delivered to the Chilean Air Force, creating a common network debriefing solution for both front-line aircraft.

In addition, each NCDR system includes some derivative of our ground data management system to enable playback of recorded data.

OPTRONIC PRODUCTS FOR AIRBORNE AND GROUND VEHICLES

The acquisition of the Vectop's assets in February 2005 provided us with a new product line. Airborne cameras are an integral part of any training and airborne debriefing system on board military platforms. Our customers include major Israeli integrators (such as IAF, IAI and Elbit), as well as foreign customers.

This product line includes:

- EYE WITNESS. An airborne heads-up display, or HUD, and a camera, that is sold to customers in different configurations. We believe that a significant part of the future revenues related to the assets purchased from Vectop will be derived from the Eye Witness. We are currently competing in an IAF bid with this product.

- NIGHT WITNESS. A night vision camera that can be installed on any pair of night vision goggles to enable the recording of the pilot's view through the night vision goggles. Its unique capability has been integrated in several fighter aircraft and helicopter programs.

- ARMOR SENTRY. A video camera developed for ground armored vehicles and tanks. This system is being delivered to the Israeli ground forces for installation in the new "Merkava" battle tank and is generating interest in foreign markets. We recently won a bid for a continuation program for the "Merkava" and began making deliveries in the fourth quarter of 2006.

- SNIPER WITNESS. The Sniper Witness enables sniper training facilities to better analyze the activities of the trainees as well as accurately debrief the operation, resulting in better training. The system is based on a miniature video camera attached to the sniper sight and a portable video recorder. The system is used by an Israeli armed forces training facility and is currently being demonstrated to other armed forces in the U.S. and Europe.

INERTIAL AND GLOBAL POSITIONING SYSTEMS BASED NAVIGATION SOLUTIONS

During 2003, we developed low cost navigation systems based on a RLG, and global positioning systems, or GPS. Our RLG based system is now qualified and operational as part of the IAF A-4 upgrade program. This development provided us with the know-how to further develop navigation solutions based on other sensors.

During 2005, we initiated a research and development program to integrate the FOG and MEMS sensors into our navigation systems Navigation systems based on these sensors are significantly more cost effective. We believe that the market for low cost navigation systems includes significantly more potential installations including ground based and marine based systems.

Today, we offer our customers our existing RLG navigation system, or RNS, as part of our avionics packages and as a stand-alone system and we also offer a MEMS based solution. We plan to offer a new FOG based navigation system by mid 2007.

ADVANCED TRAINING SOLUTIONS

Our training solutions are based on a complete and integrated system that incorporates an airborne component installed in the aircraft and a ground-based component, installed in the squadron facilities. Recent technological developments, undertaken primarily for the IAF, enable system adaptation to any kind of aircraft, regardless of its onboard avionics systems. Our more recent solutions are based on our newly developed Net Centric Digital Recorder, which allows the integration of our airborne digital video recordings with numerous other digital data components and provides the essential building blocks for a squadron information management network, or SIMNET, as a ground component.

INTEGRATED TRAINER AIRCRAFT AVIONICS PACKAGE

Following our selection by the IAF to provide our ACE(TM) integrated trainer aircraft avionics package for their advanced trainer, the A-4 Skyhawk, we were awarded a follow-on program aimed at total replacement of the aging avionics package of the A-4 aircraft with a new, upgraded package. The new avionics package replaced the legacy weapon delivery and navigation system of the aircraft with a new state-of-the-art system that significantly improved the capabilities of the A-4, increased its reliability and provided advanced training capabilities.

The upgraded system includes an inertial navigation system, or INS, GPS, HUD, camera, central weapon delivery and navigation processor based on an enhanced flight monitoring unit, which is the core of the ACE(TM) system and a control and display unit. The upgraded A-4 program was completed during 2005. We expect to negotiate the terms of an additional upgrade package to the IAF A-4 aircraft during the first half of 2007.We believe that this program places us among the few companies worldwide that performed a complete aircraft avionics system upgrade. As a result of the A-4 system development, we have proposed similar, cost effective, trainer aircraft avionics packages to other customers. The A-4 avionics package provides, at a very affordable price, a complete and modern avionics suite tailored for trainer aircraft. We have launched marketing efforts to promote this package to different customers.

FLIGHT DATA RECORDERS AND SUPPORTING GROUND ANALYSIS

GENERAL

Our fleet maintenance management solutions are based on existing programs and products developed and supplied over the course of the past three years. These programs include airborne data collection and recording equipment (such as FACE(TM) or DAS) as well as ground support software packages (such as PERFORMS) that provide the infrastructure for efficient data logging and analysis to support fleet maintenance management.

FATIGUE ANALYSIS AND AUTONOMOUS AIR COMBAT EVALUATION SYSTEM - FACE(TM)

The FACE(TM) system is an avionics system designed to acquire, process and record data from various aircraft systems as well as from strain gauges (sensors) affixed to an aircraft structure. This data is used to streamline and manage the ongoing monitoring and maintenance of an aircraft and its systems. The FACE(TM) system communicates with a squadron's ground support logistic station, enabling downloading of data from an aircraft, analyzing the data, managing ongoing maintenance, creating and modifying the set-up configuration files and determining data for recording, as well as providing an interface to other applications.

The FACE(TM) system is capable of communicating in real time with a voice and data recorder, which is a crash survival unit known as a "black box" manufactured by Smiths, for the purpose of recording flight safety related data. We are currently upgrading the FACE(TM) systems we supplied to the Royal Netherlands Air Force for its F-16 aircraft between the years 1996 and 1999. During 2004 we supplied FACE(TM) systems for the F-16 fleet of the Portuguese Air Force and for U.S. Navy aircraft, and during 2006 we supplied FACE(TM) systems to the USAF as part of an FMS upgrade for F-16 aircraft of the Jordanian Air Force. We believe that we will be able to continue to secure additional FACE(TM) contracts in the future.

DATA ACQUISITION SYSTEM - DAS

The DAS is an advanced avionics data acquisition system designed to acquire, process and record data from various aircraft systems. We developed and jointly marketed with Smith the DAS for the new IAF F-16I aircraft. DAS consists of two sub-systems, a data acquisition unit, or DAU, and an enhanced crash survival memory unit, or ECSMU. The DAU interfaces with numerous data systems and data channels in the aircraft and acquires, processes and records data, mostly for maintenance purposes. The ECSMU is a "black box" capable of recording digital data and digitized audio transferred through the DAU. The DAS is a form fit replacement for the CSFDR system, which is currently installed on most F-16 aircraft worldwide. DAS has been offered as a substitute in various projects that require a flight data recorder with advanced capabilities and growth potential.

The DAS is designed to meet all commercial aviation requirements for "black box" recorders, thus expanding its market potential. During 2004, we started supplying production DAS units to the IAF and entered into contracts to supply DAS units to the Polish Air Force and the Korean Air Force starting in 2005. Additional DAS contracts, for the USAF and others, are expected during 2008

PERFORMS (PROCESSING, EVALUATING, AND REPORTING OF FORCE MANAGEMENT DATA SOFTWARE)

Starting in mid-2001 we have been the primary sub-contractor to Lockheed Martin Aerospace in the development of a new aircraft data logging and analysis software package, known as PERFORMS. PERFORMS is designed to replace the aging and hard to support data processing station, or DPS, that was developed to provide data logging and fatigue analysis for all F-16 aircraft users. PERFORMS is a Windows 2000(R) based software package, utilizing a state-of- the-art graphics user interface, and provides all the required infrastructure to perform any type of analysis on data acquired by all legacy F-16 airborne flight data recorders.

The analysis includes fatigue monitoring, engine usage monitoring and other applications that may be added, as required by different users. The recorded data is downloaded to the station and stored in a commercial off the shelf database with an interface for "plug-in" applications, allowing those applications to access the data, manipulate and analyze it and provide a variety of maintenance management tools. The program is managed by Lockheed Martin Aerospace and is supplied to F-16 users in evolving software "builds" delivered every 12 months starting in April 2003. Updated and upgraded PERFORMS software packages were delivered during 2004 and 2005, 2006 and are scheduled for delivery in 2007. Various air force customers currently use the software, and we expect to receive requests to support the installation and operation of the software from these users.

UNMANNED AERIAL VEHICLES AVIONICS

We identified the UAV avionics market as a fast growing that will gradually replace the manned military airborne avionics. This market has many common aspects with manned avionics product lines; however, it requires slightly different technology and understanding of the various requirements.

Typically, a UAV avionics package needs to be smaller, lighter, more reliable and inexpensive than its comparable manned aircraft suite. The major advantage of UAV avionics systems is the anticipated large number of UAVs that will be required in the future.

We initiated efforts to penetrate this market during 2001. Since then we have entered into a contract with IAI to develop and provide an Input Output Controller, or IOC, a unit that is part of our data acquisition systems product line, for IAI's next generation UAV. We are continuing our efforts to widen our participation in this important program as well as in other programs. The development of this product was completed, and it is currently in production, including various derivatives that were added to a complete package that incorporates 10 units per aircraft. In addition, we have won and are delivering other types of units for the same UAV model which includes up to 23 units per aircraft. This numbers will provide us with significant sales volume when the UAV program serial production picks up.

During 2004, we developed and delivered a miniature avionics module (MAM) to IAI. This unit is aimed at the miniature UAV market and provides complete avionics capabilities in a single miniaturized unit. This unit was recently selected for a miniature UAV sold by IAI to a foreign customer and we expect to be under contract for delivery of serial units during 2007

AUTOMATIC TESTING SOLUTIONS

Our business expansion into the automatic test equipment, or ATE, market is based on our existing products as well as the added value we deliver with the dedicated expertise and the wide-range experience we have acquired in this area. We rely on the preference indicated by OEMs in the past to outsource the acquisition of ATE and have positioned our company as a strategic supplier/partner to provide ATE and test solutions. We offer our ATE with our own Advanced Test Environment, including all the required development tools. After a long period of inactivity in this market, we see some growing interest, especially from smaller maintenance companies rather than from airlines, especially in the U.S.

COMMERCIAL AVIATION TEST STATIONS - CATS(TM)

The Commercial Aviation Test Stations, or CATS(TM), is a family of multi-purpose, computerized automatic test equipment that meets the specific needs of airlines and third party maintenance companies. The CATS(TM) stations test and repair a variety of electronic units in existing commercial aircraft, incorporating tools for testing, troubleshooting, and performing diagnostic procedures. CATS(TM) stations replace or augment test stations from aircraft manufacturers or avionics OEM suppliers, while automating multiple manual test procedures.

MANUFACTURING SERVICES

In 2000, we began providing manufacturing services to OEMs located in Israel and the United States, using the excess manufacturing capacity at our Beit She'an plant. We offer manufacturing turnkey solutions, either in "build to print" or "build to specification" modes. To date, we have provided our manufacturing services to Smiths, IAI, RAFAEL, and other Israeli companies, both in the defense and commercial sectors.

TEST AND REPAIR STATIONS

We operate a test and repair shop based on the use of our CATS(TM) tester in Beijing, China through CACS, our 80% owned Chinese subsidiary. CACS was established as a joint venture company with Tianzu Forest Development Company, which owns the remaining 20% equity interest. Pursuant to the joint venture agreement, Tianzu Forest Development provided the facilities for CACS' operations while we provided CATS(TM) testers and test program set services.

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SALES AND MARKETING

STRATEGY

Our sales and marketing strategy is based on the following principles:

- Maintaining our business focus on avionics for the military market and our family of testing solutions for the commercial and military markets.

- Expanding our product offerings of our four product lines, by adding new applications to our existing products.

- Expanding our customer base by including our products in solutions and integrated systems.

- Establishing marketing channels with system integrators and major aircraft manufacturers such as The Boeing Company, Lockheed Martin Aerospace, Smiths, IAI, RAFAEL and others.

- Expanding large potential markets, especially in the military and the unmanned combat air vehicle areas, and developing new marketing channels aimed directly at these customers.

STRATEGIC RELATIONSHIPS

As part of our strategy, we have entered into a number of strategic relationships and have focused our marketing and sales efforts to support these relationships.

LOCKHEED MARTIN AEROSPACE. Our sales of avionics products focus mainly on the F-16 aircraft manufactured by Lockheed Martin Aerospace, the most popular fighter aircraft in the Western world today. In February 1999, we signed a memorandum of understanding with Lockheed Martin pursuant to which we agreed to provide certain avionics systems for the F-16 aircraft under the PM-V Program. In September 1999, the U.S. and the State of Israel signed a letter of acceptance pursuant to which the U.S. agreed to provide the IAF with 50 F-16I aircraft and an option for an additional 52 aircraft, which was exercised in June 2001 for a total of 102 F-16I aircraft. In cooperation with Smiths, we are developing and supplying the data acquisition system that includes the advanced data acquisition unit and an enhanced crash survivable memory unit, which will be manufactured in our Beit She'an facility. In addition, in March 2001 we signed an agreement with the Aircraft Structural Integrity Program Group of Lockheed Martin pursuant to which we are assisting in the development of a fatigue analysis system based on a PC computer for analyzing structural fatigue of the F-16 aircraft. As the main subcontractor, our principal task is to develop the software for the fatigue analysis system. The fatigue analysis system will utilize data collected from the data acquisition unit and our FACE(TM) system, as well as other systems used by air forces operating F-16 aircraft. In 2006 we were chosen by Lockheed Martin to supply the baseline NCDR for all F-16 FMS sales and upgrades.

SMITHS AEROSPACE ELECTRONIC SYSTEMS. In February 1999, we entered into an agreement with Smiths that outlined joint marketing activities for our FACE(TM) system and Smiths' voice and data recorder for F-16 A/B aircraft. Smiths is a worldwide leader in avionics systems for fighter and commercial aircraft. The two systems successfully passed flight tests conducted on the Royal Netherlands Air Force's F-16 aircraft by Lockheed Martin and the Royal Netherlands Air Force. The FACE(TM) system and the voice and data recorder complement each other and are intended to serve as a data acquisition system that replace outdated data recording systems, mechanical strain recorders and flight load recorders.

In October 2003, we signed a teaming agreement with Smiths. The teaming agreement establishes cooperation in connection with the products for the PM-V Program and its derivatives. In addition, the agreement details commitments made by Smiths to purchase production services from us in the future.

During 2004, we expanded our cooperation with Smiths to include our newly developed Net Centric Digital Recorder and have jointly offered this product to potential customers. In late 2006, we entered into a contract in the US for the adaptation and production of the NCDR for various platforms, including the US NAVY T-45 and for Foreign Military Sales of F-16.

In addition to the cooperation with Smiths in connection with the PM-V Program, we are currently supplying the Royal Netherlands Air Force with an integration package for our FACE(TM) System and Smiths' black box for its F-16 MLU fleet. A similar package is also being supplied to the Portuguese Air Force and the Royal Jordanian Air Force.

ISRAEL AIRCRAFT INDUSTRIES. IAI was our second largest customer in 2006, accounting for approximately 20% of our total revenues. We are actively supplying avionics and test equipment to four different divisions of IAI. We have identified the Israeli government-owned aerospace industries as potential customers and cooperation entities. In particular the Lahav and Malat divisions of IAI, major aircraft integrators, require our services as an avionics and test equipment providers.

MARKETING

Our chairman and chief executive officer, Herzle Bodinger and our vice president business development, Zvi Alon, lead our marketing efforts. We currently employ five other persons in marketing our core business products. Our engineering department supports our marketing staff with respect to product pricing and technical demonstrations. In addition, we have sales consultants, agents and representatives in Europe, South America, and India who receive commissions for sales effected through them.

The Israeli Ministry of Defense has historically supported and continues to support our marketing efforts through its Export and Defense Assistance division, or SIBAT, through various projects for the Israeli Defense Forces and its related divisions. The Israeli Ministry of Industry and Commerce supports our marketing efforts via its Industrial Cooperation Authority through the exploitation of "offset commitments" by Lockheed Martin Aerospace and The Boeing Company to the State of Israel. Such future assistance is not guaranteed.

FIXED PRICE CONTRACTS

Most of our contracts, especially with the Government of Israel, its agencies and other foreign governments, are generally fixed-price contracts. Under fixed-price contracts, the price is not subject to adjustment by reason of the costs incurred in the performance of the contracts, as long as the costs incurred and work performed fall within governmental guidelines. Under our fixed-price contracts, we assume the risk that increased or unexpected costs may reduce our profits or generate a loss. This risk can be particularly significant under a fixed-price contract for research and development involving a new technology.

Our books and records may be subject to audits by the Israeli Ministry of Defense and other governmental agencies including the U.S. Department of Defense. These audits may result in adjustments to contract costs and profits. To date, we have not incurred any liability as a result of such audits.

PRINCIPAL CUSTOMERS

Generally, we complete a few major transactions each year, each in an amount comprising approximately 10% of our revenues for such year. As a result, each year a significant portion of our revenues is derived from a small number of customers. The following table sets forth our principal customers in 2005 and 2006:

	2005	2006
Smiths Electronic Systems .	21%	38%
The Boeing Company	3%	-
Israeli Ministry of Defense	12%	5%
Israel Aviation Industries	14%	20%
Portuguese Air Force	-	2%
U.S. Navy	-	-

Lockheed Martin	12%	9%
Hindustan Aeronautics	5%	3%

Although we are striving to increase the number of our customers, we anticipate that a significant portion of our future revenues will continue to be derived from sales to a small number of customers.

Like many companies deriving a substantial portion of their revenues from government contracts, we are subject to business risks, including changes in governmental appropriations and changes in national defense policies and priorities. Although many of the programs in which we participate as a contractor or subcontractor may extend for several years, our business is dependent upon annual appropriations and funding of new and existing contracts. Most of the contracts are subject to termination for the convenience of the customer, pursuant to which the customer pays only for reimbursement of costs incurred and the applicable profit on work performed. The Israeli Government or any other government may discontinue funding the purchase of our products over the long term.

MARKETS

We sell our products to various air forces and companies worldwide. The following table presents our revenues by geographical market for the periods indicated:

	2004	2005	2006
Israel	35%	41%	33%
North America	33%	38%	36%
Europe	21%	5%	6%
Other (mainly India and Central America)	10%	16%	25%

COMPETITION

The markets for our products are highly competitive. Our principal competitors in the avionics market are Harris, Rockwell Collins, Honeywell, Elbit Systems Ltd., IAI, R.S.L. Ltd., TEAC and Elisra Systems Ltd. We expect to continue to face competition from these and other competitors. Most of our competitors are larger, have greater resources including financial, technological, marketing and distribution capabilities, and enjoy greater market recognition than we do. These competitors may be able to achieve greater economies of scale and may be less vulnerable to price competition than us. We may not be able to offer our products as part of integrated systems to the same extent as our competitors or successfully develop or introduce new products that are more cost effective or offer better performance than those of our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.

EXPORT POLICY

Exports of military related products are subject to the military export policy of the State of Israel. Current Israeli Government policy encourages export to approved customers of military products similar to those manufactured by us, provided that such export does not run counter to Israeli policy or national security considerations. We must obtain a permit to initiate a sales proposal and ultimately an export license for the transaction is required. We may not obtain export permits or licenses in the future and the Israeli governmental policy with respect to military exports may be altered. However, to date we have not encountered any significant difficulties in obtaining necessary permits or licenses for sale of our products.

PROPRIETARY INFORMATION

We hold a patent for our ACE(TM) system in both Israel and the United States, No. 5467274. In addition, in connection with the assets we acquired from Vectop Ltd. in February 2005, we have acquired the rights to the following patents and patent applications: Israeli patents No. 121042, No. 116131, No. 124816 and No. 1088253, U.S. patents No. 6,061,182, No. 5,742,434, No. 6,301,052 and No. 5,699,440, European patents (France England and Italy) No. 0777142 and No. 1088253, Indian patent application No. IN/PCT/200/00611 and Japanese patent application No. 329384/94.. Nevertheless, we generally do not consider patent protection significant to our current operations and rely upon a combination of security devices, copyrights, trademarks, trade secret laws and contractual restrictions to protect our rights in our products. Our policy is to require employees and consultants to execute confidentiality agreements upon the commencement of their relationships with us. These measures may not be adequate to protect our technology from third-party infringement, and our competitors might independently develop technologies that are substantially equivalent or superior to ours. Additionally, our products may be sold in foreign countries that provide less protection for intellectual property rights than that provided under U.S. or Israeli laws.

The Israeli Government usually retains certain rights to technologies and inventions resulting from our performance as a prime contractor or subcontractor under Israeli Government contracts and may generally disclose such information to third parties, including other defense contractors. When the Israeli Government funds research and development, it may acquire rights to proprietary data and title to inventions; we may retain a non-exclusive, royalty-free license for such inventions. However, if the Israeli Government purchases only the end product, we may retain the principal rights and the Government may use the data and take an irrevocable, non-exclusive, royalty-free license.

MANUFACTURING AND SUPPLY

Our main production facilities are located in Beit She'an, Israel. The plant is equipped to handle most of our manufacturing processes and testing requirements. For several specific processes we utilize subcontractors. This approach is a key to our flexibility and versatility.

We stress quality control in our product realization process. Commencing with customer requirements and expectations via raw material inspection through completion, specifications are repeatedly checked. We maintain a quality assurance team that participates in every stage of the design and manufacture of our products. Our quality management standards are certified by the Standards Institute of Israel, or SII, pursuant to ISO 9001 for hardware design and production and ISO 9000.3 for software, both since 1995. SII performs quality system audits twice a year and various customers perform audits four to six times a year. In April 2001, SII certified our environmental management system pursuant to ISO 14001. Our quality management system was revised to comply with ISO 9001:2000 in June 2003. During 2005 we were certified according to AS-9100, a quality management system for aerospace requirements.

According to the standard warranty incorporated in most of our sales contracts, we warrant that our products will be free from defects in design, materials or workmanship, and guarantee repair or replacement of defective parts for a period of one to two years following delivery of a product to the customer. We also provide maintenance services to customers who sign maintenance contracts.

SOURCE AND AVAILABILITY OF RAW MATERIALS

We acquire most of the components for the manufacturing of our products from a limited number of suppliers and subcontractors, most of whom are located in Israel and the United States. Certain of these suppliers are currently the sole source of one or more components upon which we are dependent. Since many of our purchases require long lead-times, a delay in supply of an item can significantly delay the delivery of a product. To date, we have not experienced any particular difficulty in obtaining timely deliveries of necessary components. See Item 3D "Risk Factors." We depend on a limited number of suppliers of components for our products and if we are unable to obtain these components when needed, we would experience delays in manufacturing our products and our financial results could be adversely affected.

C. ORGANIZATIONAL STRUCTURE

We had one active subsidiary in 2006, Beijing Huarui Aircraft Components Maintenance and Services Co., an 80% owned subsidiary based in China that is engaged in aircraft repair services.

D. PROPERTY, PLANTS AND EQUIPMENT

We own a 30,000 square feet building in Beit She'an, Israel. The building, which includes manufacturing facilities, warehouse space and a portion of our development facilities, is situated on land leased from the Israel Land Authority for a period of 49 years until 2034. The plant has sufficient capacity to meet our current requirements. If volume was to increase significantly, we believe that we will be able to increase the number of workers or shifts at the plant, or use more subcontractors.

Our executive offices and research and development facilities are located in a 12,500 square foot office facility in Netanya, Israel. The lease for this facility expires in January 2008.

Our Chinese subsidiary, CACS, conducts its business in an approximately 16,000 square foot facility in Beijing that includes offices and test and repair facilities. The land for this facility was leased by Beijing Tianzu Forestry Company or Tianzu, the minority shareholder in CACS, from the Chinese government for 30 years. Under a joint venture agreement, and in consideration for its equity investment in CACS, Tianzu granted CACS usage rights in the land, constructed the buildings and granted CACS the ownership of these buildings. However, the transfer of the title to the land and the buildings has not been completed. Although Tianzu is legally obligated to complete such transfer of title to the land and the buildings, we can not guarantee that such transfer will be completed, or that we will not be required to initiate litigation in order to enforce our rights to receive title to the land and buildings. In January 2007, we met with Tianzu and discussed a potential resolution whereby Tianzu will withdraw from the joint venture, waiving their interest in the joint venture, while obtaining title to the land and building.

The aggregate annual rent for our offices in Israel was approximately $177,000 in 2006.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. OPERATING RESULTS

THE FOLLOWING DISCUSSION OF OUR RESULTS OF OPERATIONS SHOULD BE READ TOGETHER WITH OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES, WHICH APPEAR ELSEWHERE IN THIS ANNUAL REPORT. THE FOLLOWING DISCUSSION CONTAINS FORWARD-LOOKING STATEMENTS THAT REFLECT OUR CURRENT PLANS, ESTIMATES AND BELIEFS AND INVOLVE RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE DISCUSSED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE OR CONTRIBUTE TO SUCH DIFFERENCES INCLUDE THOSE DISCUSSED BELOW AND ELSEWHERE IN THIS ANNUAL REPORT.

OVERVIEW

We develop, manufacture and sell automated test equipment, avionics products and ground debriefing systems and provide manufacturing services for military and commercial use, mainly in Israel, the U.S. and Europe. We also provide test and repair services using our CATS(TM) testers and test program sets through our Chinese subsidiary.

GENERAL

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. All references in this annual report to "dollars" or "$" are to U.S. dollars and all references in this annual report to "NIS" are to New Israeli Shekels. Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in other currencies are remeasured into dollars in accordance with the principles set forth in Financial Accounting Standards Board Statement No. 52. The majority of our sales are made outside Israel and a substantial part of them are in dollars. In addition, a substantial portion of our costs are incurred in dollars. Since the dollar is the primary currency of the economic environment in which we and our subsidiary operate, the dollar is our functional and reporting currency and, accordingly, monetary accounts maintained in currencies other than the dollar are remeasured using the foreign exchange rate at the balance sheet date. Operational accounts and non monetary balance sheet accounts are measured and recorded at the exchange rate in effect at the date of the transaction. All monetary balance sheet accounts have been remeasured using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been remeasured using the average exchange rate for the period.

On February 14, 2007, we effected a one share for three shares reverse stock split with respect to our ordinary shares. All share and per share amounts in this report have been restated for all prior periods to reflect the reverse stock split.

DISCUSSION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATIONS

Our critical accounting policies, including the assumptions and judgments underlying them, are disclosed in the notes to our consolidated financial statements. These policies have been consistently applied in all material respects. While the estimates and judgments associated with the application of these policies may be affected by different assumptions or conditions, we believe the estimates and judgments associated with the reported amounts are appropriate in the circumstances.

We believe the following accounting policies are the most critical in fully understanding and evaluating our financial condition and results of our operations under U.S. generally accepted accounting principles.

REVENUE RECOGNITION. Our revenues mainly derived from sales of automated test equipment and avionics products and from long-term fixed price contracts for ATE, avionics and ground debriefing systems. In addition, we lease ATE and provide manufacturing, development and product support services. Product revenue is recognized when there is persuasive evidence of an arrangement, the fee is fixed or determinable, delivery of the product to the customer has occurred and the collection of the fee is probable. If the product requires specific customer acceptance, revenue is deferred until customer acceptance occurs or the acceptance provisions lapse, unless we can objectively and reliably demonstrate that the criteria specified in the acceptance provisions are satisfied.

Revenues from long-term fixed price contracts are recognized by the percentage-of-completion method in accordance with the "Input Method." We apply this method when the total of the costs and revenues of the contract can reasonably be estimated. The percentage of completion is determined based on the ratio of actual costs incurred to total costs estimated to be incurred over the duration of the contract. With regard to contracts for which a loss is anticipated, a provision is made for the entire amount of the estimated loss at the time such loss becomes evident. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit or loss are recorded in results of operations when they are reasonably determined by management on a cumulative catch-up basis.

Revenues from services are recognized when the service is performed. Revenue under operating leases of equipment are recognized ratably over the lease period. Revenues from certain arrangements may include multiple elements within a single contract. Generally, our arrangements are accounted for as separate units of accounting when it is possible to determine objective and reliable evidence of fair value of the undelivered elements in order to separate the fees among the elements. Revenue is recognized when the element is delivered and all other criteria for revenue recognition are met.

Revenues from software arrangements are recognized when persuasive evidence of an arrangement exists, delivery of the product has occurred, the fee is fixed or determinable, and collectability is probable. Arrangements with payment terms extending beyond customary payment terms are considered not to be fixed or determinable. If the fee is considered not to be fixed or determinable, revenue is deferred and recognized when payments become due from the customer or are actually collected when collectability is not probable, providing that all other revenue recognition criteria have been met.

INTANGIBLE ASSETS. Costs of producing our TPS software library, which can be integrated with our CATS test station, incurred subsequent to achieving technological feasibility, were capitalized, and are amortized by the greater of the amount computed using the: (i) ratio that current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the software. We assess the recoverability of these intangible assets at each balance sheet date by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software products sold. The use of different assumptions with respect to the expected cash flows from our assets and other economic variables may lead to different conclusions regarding the recoverability of our assets' carrying values and to the potential need to record an impairment loss for our intangible assets. An intangible asset related to customer relationships has been recorded as a result of our acquisition of certain assets and liabilities of Vectop in February 2005 and is being amortized using a straight line basis over the expected useful life of five years. For the year ended December 31, 2006, we recorded $19,000 of impairment charges on specific TPS's from which we do not anticipate to derive future revenues.

IMPAIRMENT OF LONG-LIVED ASSETS. We are required to assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We assess the impairment of our assets based on a number of factors, including any significant changes in the manner of our use of the respective assets or the strategy of our overall business and significant negative industry or economic trends. Upon determination that the carrying value of a long-lived asset may not be recoverable, based upon a comparison of expected undiscounted future cash flows to the carrying amount of the asset, an impairment charge is recorded in the amount the carrying value of the asset exceeds its fair value. For the year ended December 31, 2006, no impairment was required.

SHARE-BASED COMPENSATION. Effective January 1, 2006, we account for stock-based compensation in accordance with FASB Statement No. 123 (Revised 2004), "Share-Based Payment," or SFAS 123(R), applying the modified prospective method, and with Securities and Exchange Commission Staff Accounting Bulletin No. 107, "Share-Based Payment," or SAB 107. In accordance with SFAS 123(R), we measure the compensation cost associated with share-based payment transactions based on the fair value at the grant date of the options. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods, according to the straight-line method.

For employee option grants, the fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with weighted average assumptions relating to the dividend yield, expected volatility, risk free interest rate, expected life of the option by the employee and estimated forfeiture rates, in accordance with SAB 107. Changes in our assumptions with respect to these components may change the compensation award costs and amounts expensed in each period and consequently the results of our operations. For the year ended December 31, 2006 we incurred share-based compensation expense of $ 221,000. As of December 31, 2006, there was $ 270 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's stock option plans, which are expected to be recognized over a weighted-average period of one year.

Prior to the adoption of SFAS 123(R), the Company applied SFAS 123, amended by SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," which allowed companies to apply the existing accounting rules under APB 25, "Accounting for Stock Issued to Employees," and related Interpretations. In general, as the exercise price of options granted under these plans was equal to the market price of the underlying common stock on the grant date, no stock-based employee compensation cost was recognized in the net loss attributed to common stockholders for periods prior to the adoption of SFAS 123(R).

PROVISION FOR LITIGATION. We have an outstanding balance of loans due to us from our former chief executive officer and a former officer. Both officers claim that they are not obliged to repay the loans. We are engaged in legal actions with our former officers concerning, among other things, the repayment of the loans. According to our legal consultants, we have a strong case with regard to our claims for repayment of the outstanding loans. We recorded a provision for the loans receivable in the amount that we believe is sufficient to reflect the recoverability of the asset, based on management's estimation. In addition, we have several additional legal proceedings outstanding. We have recorded provisions for litigation for claims that were estimable and for which there is a high probability that we will be held responsible based on our legal consultants' opinions and management's estimations. If our estimations are wrong, we may incur additional litigation expenses.

FAIR VALUE OF WARRANTS. In July 2004, we consummated a private placement, whereby we issued 600,000 shares, an aggregate of $3 million principal amount of convertible notes and warrants (including additional investment rights) to purchase an aggregate of 679,167 ordinary shares to investors for a total consideration of $5.7 million, net of issuance expenses. The consideration was allocated based on the respective fair values of the ordinary shares, notes, warrants and additional investment rights. The fair value of the warrants and the additional investment rights was based on a valuation prepared by an independent, valuation expert using the Black-Scholes pricing model. The valuation result was judged to be reasonable by our management based on comparisons to benchmarks in similar circumstances.

SIGNIFICANT EXPENSES

Cost of Revenues. Cost of revenues consist primarily of manufacturing costs, depreciation of fixed assets, project development costs, impairment losses on long-lived assets, amortization of capitalized software and inventories write-downs.

MARKETING, SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Marketing and selling expenses consist primarily of expenses for sales and marketing personnel, sales commissions, marketing activities, public relations, promotional materials, amortization of customer relationship assets, travel expenses and trade show exhibit expenses. General and administrative expenses consist primarily of salaries and related expenses for executive, accounting, administrative personnel, professional fees, provisions for doubtful accounts, and other general corporate expenses.

FINANCIAL INCOME (EXPENSES), NET. Financial expenses consist of interest and bank expenses, interest on convertible note and loans, amortization expenses of discount on convertible note, deferred expenses and currency remeasurement losses. Financial income consists of interest on cash and cash equivalent balances and currency remeasurement gains.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements". This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We believe this Standard will not have a material effect on our consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), an interpretation of SFAS 109, "Accounting for Income Taxes". FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions shall initially be recognized in the financial statements when it is more-likely-than-not the position will be sustained upon examination by the tax authorities. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements to include an annual tabular roll forward of unrecognized tax benefits. The provisions of this interpretation are required to be adopted for fiscal periods beginning after December 15, 2006. We will be required to apply the provisions of FIN 48 to all tax positions upon initial adoption with any cumulative effect adjustments to be recognized as an adjustment to retained earnings. Based on our initial evaluation as of December 31, 2006, we do not believe that FIN 48 will have a material impact on its financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," ("SFAS No. 159"), which permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We will adopt SFAS No. 159 no later than January 1, 2008. We have not yet determined the effect that the adoption of SFAS No. 159 will have on our consolidated financial statements.

YEAR ENDED DECEMBER 31, 2006 COMPARED WITH YEAR ENDED DECEMBER 31, 2005

Revenues. Our revenues decreased 3% to $13.0 million in 2006 from $13.4 million in 2005. We expect that in 2007 our revenues will be primarily generated from sales of our new products.

Cost of Revenues. Cost of revenues decreased 9% to $11 million in 2006 from $12.1 million in 2005. The decrease is mainly due to the decreased revenues from development programs which have lower profit margins. In 2007, we expect that our cost of revenues as a percentage of revenues will continue to decrease.

GROSS PROFIT. Our gross profit increased 54% to approximately $2.0 million in 2006 from $1.3 million in 2005. Our profit margin increased to 16% in 2006 from 10% in 2005. The improved margins reflects the mix between the traditional and new products that we sell and the lower margin of certain long-term fixed price contracts whereby new products are being developed for our customers.

RESEARCH AND DEVELOPMENT EXPENSES. In 2006 we incurred $181,000 of research and development expenses. In 2005 we did not incur any research and development expenses as we made a strategic decision not to engage in internal research, and development activities, but entered into development projects through customers orders. In 2007, we expect that we will continue to enter into new development projects and develop products through customer orders, but will also initiate internally funded research.

MARKETING, SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Marketing, selling, general and administrative expenses were approximately $3.1 million in both 2006 and in 2005. While we continue to implement our costs savings measures, we also continued to support our sales efforts in our current and new markets. We expect that marketing and selling expenses will remain at the same level in 2007.

FINANCIAL INCOME (EXPENSES), NET. Our financial expenses, net, were $775,000 in 2006 compared to $624,000 in 2005. Our increased financial expenses in 2006 were attributable primarily to the interest payable and amortization expense on the deemed discount on the $3 million of convertible notes issued in 2004 and to higher interest rates.

YEAR ENDED DECEMBER 31, 2005 COMPARED WITH YEAR ENDED DECEMBER 31, 2004

Revenues. Our revenues decreased 5% to $13.4 million in 2005 from $14.1 million in 2004. The decrease in our revenues is primarily attributable to our being engaged in a higher proportion of development programs and a decrease in sales of off-the-shelf products. We expect that in 2006 our revenues will be primarily generated from sales of our new products and from the products acquired in our purchase of certain assets of Vectop.

Cost of Revenues. Cost of revenues increased 17% to $12.1 million in 2005 from $10.3 million in 2004. The increase is mainly due to the increased expenses attributable to development programs, which have lower profit margins. In addition, 17% of such increase is due to a write-down of inventories.

GROSS PROFIT. Our gross profit decreased 66% to approximately $1.3 million in 2005 from $3.9 million in 2004. Our profit margin decreased to 8% in 2005 from 27% in 2004. The decrease in gross margin is due to the mix between the traditional products that we sell and the lower margin of certain long-term fixed price contracts whereby new products are being developed for our customers.

RESEARCH AND DEVELOPMENT EXPENSES. In 2005 and 2004 we did not incur any research and development expenses. We made a strategic decision not to engage in internal research, and development activities, but entered into development projects through customers orders.

MARKETING, SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Marketing, selling, general and administrative expenses were approximately $3.1 million in 2005 and $2.9 million in 2004. While we continue to implement our costs savings measures, we also continued to support our sales efforts in our current and new markets.

FINANCIAL INCOME (EXPENSES), NET. Our financial expenses, net, were $624,000 in 2005 compared to $248,000 in 2004. Our increased financial expenses in 2005 were attributable primarily to the interest payable on the $3 million of convertible notes issued in 2004 and to higher interest rates. Foreign currency exchange differences and amortization expenses on convertible notes and deferred charges also contributed to the increase of our financial expenses.

CONDITIONS IN ISRAEL

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. Accordingly, we are directly affected by political, economic and military conditions in Israel. Specifically, we could be adversely affected by any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, and a significant downturn in the economic or financial condition of Israel.

POLITICAL CONDITIONS

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. In 1979 Israel signed a peace agreement with Egypt under which full diplomatic relations were established. In October 1994 a peace treaty was signed between Israel and Jordan which provides, among other things, for the commencement of full diplomatic relations between the two countries. To date, there are no peace treaties between Israel and Syria or Lebanon.

Since 1993, several agreements have been signed between Israel and the Palestinian representatives concerning conditions in the West Bank and Gaza and outlining several interim Palestinian self-government arrangements. The implementation of these agreements have been subject to difficulties and delays.

Since September 2000, there has been a marked increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza. These developments have adversely affected the regional peace process, placed the Israeli economy under significant stress, and have negatively influenced Israel's relationship with several Arab countries. In August 2005, Israel evacuated all Israeli settlements in the Gaza Strip and four settlements in the West Bank. In July 2006, an armed conflict began between Israel and Hezbollah forces in Lebanon, which involved rocket attacks on populated areas in the northern parts of Israel. On August 14, 2006, a cease-fire between Hezbollah and Israel took effect. This situation has had an adverse effect on Israel's economy, primarily in the geographical areas directly harmed by this conflict. Any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development or 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 we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

Many of our executive officers and employees in Israel are obligated to perform annual military reserve duty and are subject to being called for active duty under emergency circumstances. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business. To date, no executive officer or key employee has been recruited for military service for any significant time period. Any further deterioration of the hostilities between Israel and the Palestinian Authority into a full-scale conflict might require more significant military reserve service by some of our employees, which may have a material adverse effect on our business.

ECONOMIC CONDITIONS

In recent years Israel has been going through a period of recession in economic activity, resulting in low growth rates and growing unemployment. Although economic activity in Israel has improved recently, our operations could be adversely affected if the economic conditions in Israel begin to deteriorate again.

TRADE RELATIONS

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade Organization and is a signatory to the General Agreement on Tariffs and Trade. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

Israel and the EEC, known now as the "European Union," concluded a Free Trade Agreement in July 1975 that confers some advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area. The Free Trade Area has eliminated all tariff and some non-tariff barriers on most trade between the two countries. On January 1, 1993, an agreement between Israel and the European Free Trade Association, known as the "EFTA," established a free-trade zone between Israel and the EFTA nations. In November 1995, Israel entered into a new agreement with the European Union, which includes a redefinition of rules of origin and other improvements, such as allowing Israel to become a member of the Research and Technology programs of the European Union. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, China, India, Turkey and other nations in Eastern Europe and Asia.

Israel receives significant amounts as economic assistance from the United States. In the last several years Israel has received from the U.S. approximately $3 billion per year. We cannot assure you that U.S. economic assistance will continue, or that the amounts received will not be reduced. If U.S. economic assistance is eliminated or reduced significantly, the Israeli economy could suffer material adverse consequences which may have material adverse impact on our financial condition and results of operations.

CORPORATE TAX RATE

Israeli companies are generally subject to income tax at the corporate tax rate. The applicable rate for 2006 of 31%, will be reduced to 29% in 2007, and will be further reduced to 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

As of December 31, 2006, our carried forward net operating loss for Israeli tax purposes was approximately $46 million, including a carry forward capital loss amounting to approximately $3 million.

IMPACT OF CURRENCY FLUCTUATION AND OF INFLATION

For many years prior to 1986, the Israeli economy was characterized by high rates of inflation and devaluation of the Israeli currency against the dollar and other currencies. However, since the institution of the Israeli Economic Program in 1985, inflation, while continuing, has been significantly reduced and the rate of devaluation has substantially diminished. Because governmental policies in Israel linked exchange rates to a weighted basket of foreign currencies of Israel's major trading partners, the exchange rate between the NIS and the dollar remained relatively stable during reported periods.

The following table sets forth, for the periods indicated, information with respect to the rate of inflation in Israel, the rate of devaluation of the NIS against the U.S. dollar, and the rate of inflation in Israel adjusted for such devaluation:

Year ended December 31,	Israeli inflation rate %	Israeli devaluation rate %	Israeli inflation adjusted for devaluation %
2002	6.8	7.3	0.7
2003	(1.9)	(7.6)	6.1
2004	1.2	(1.6)	2.8
2005	2.4	6.8	(4.1)
2006	(0.1)	(8.2)	8.8

Since most of our sales are quoted in dollars and in other foreign currencies, and a significant portion of our expenses are incurred in NIS, our results are adversely affected by a change in the rate of inflation in Israel when such change is not offset (or is offset on a lagging basis) by a corresponding devaluation of the NIS against the dollar and other foreign currencies. We do not use any hedging instruments in order to protect ourselves from currency fluctuation and of inflation risks.

B. LIQUIDITY AND CAPITAL RESOURCES

We have historically met our financial requirements primarily through cash generated by operations, funds generated by our public offering in 1985, private placements of our ordinary shares and issuance of debt securities, loans from our principal shareholders, short-term loans and credit facilities from Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M., our Banks, research and development grants from the Government of Israel and the Israel-U.S. Binational Industrial Research and Development Foundation, and investment grants for approved enterprise programs and marketing grants from the Government of Israel.

As a result of continuing losses during the period 1999 through 2002 that amounted to $58.5 million, we were forced to incur significant debt and issue equity securities. During the four years ended December 31, 2003, we relied predominantly on Mr. Howard P.L Yeung and our other principal shareholders, and to a lesser extent on new investors to provide us with working capital. During this period, they provided us with $13.1 million in equity capital, convertible debt and loans.

On April 23, 2002, we entered into a loan agreement with Mr. Yeung, according to which he provided us with a $550,000 loan facility. The purpose of the facility was to provide us with short term working capital and in 2002 we utilized $350,000 of the facility.

At an extraordinary meeting of shareholders held on June 9, 2002, our shareholders approved the terms of a purchase agreement between us and certain investors, pursuant to which such investors purchased 646,258 of our ordinary shares at a price of $1.47 per share, which was equal to 70% of the average closing price of the ordinary shares for the ten (10) trading days prior to June 9, 2002. In addition, pursuant to the approval of our shareholders, we issued to such investors warrants to purchase 1,434,014 of our ordinary shares. Such warrants have a term of five years and are exercisable during the first 36 months after issuance at an exercise price of $6.00 per share, and during the subsequent 24 month period, at an exercise price which will be equal to the higher of: (i) $6.00 per share or (ii) 50% of the average closing price during the ten (10) trading days prior to an exercise date. The warrants contain certain anti-dilution provisions that could reduce the exercise price of the warrants in the event that we issue securities at a price below the exercise prices of the warrants our shareholders also approved the conversion of the $450,000 of loans granted by Mr. Yeung, into 918,367 of our ordinary shares at a price of $1.47 per share, which was equal to 70% of the average closing price of our ordinary shares for the ten trading days prior to the date of shareholder approval. As part of the transaction, we issued to Mr. Yeung on June 30, 2002 warrants to purchase 2,755,102 ordinary shares. Such warrants will be outstanding for five years and will be exercisable during the first 36 months at an exercise price of $6.00 per share, and during the subsequent 24 month period, at an exercise price which shall be equal to the higher of: (i) $6.00 per share or (ii) 50% of the average closing price of our ordinary shares during the ten (10) trading days prior to the exercise date. Under the terms of the purchase agreements, we also agreed to provide the investors and Mr. Yeung with certain registration rights.

On June 22, 2003, we signed a memorandum of agreement with our Banks, which agreement was approved by our shareholders at an extraordinary general meeting of shareholders that was held on July 22, 2003. Pursuant to an agreement that was finalized on September 24, 2003, we restructured $3,451,000 of our outstanding debt to the Banks. We repaid $1,100,000 on account of our debt to the Banks, and the Banks forgave $1,100,000 of debt and received warrants to purchase 1,260,665 of our ordinary shares, at an exercise price that is equal to the nominal (par) value of our shares, in lieu of $1,251,000 of our debt. The Banks also granted us an additional short-term line of credit of $500,000 to finance our cash flow requirements during 2003. As part of the agreement our controlling shareholder, Mr. Yeung, agreed to grant the Banks a put option allowing the Banks to require him to purchase the warrants granted to the Banks, for the consideration of $1,251,000, exercisable within a period of 45 days commencing on March 24, 2005 and the Banks granted Mr. Yeung a call option allowing him to require the Banks, during a period of 18 months, commencing as of September 24, 2003, and in the event that the Banks will not exercise their put option, during additional 90 days period commencing as of May 9, 2005, to sell him such warrants at a price that is not lower than $1,251,000 and not higher then $1,770,165, depending on the average closing price of our ordinary shares during the last 90 business days prior to such exercise. In May 2005, Mr. Yeung exercised his call option to purchase the warrants from the Banks and in October 2005, exercised these warrants. Upon such exercise, we issued Mr. Yeung 1,260,665 ordinary shares. We also agreed to grant the Banks warrants to purchase an additional 366,667 ordinary shares at an exercise price of $6.00 per share, exercisable for five years, commencing as of September 24, 2003.

On July 12, 2004 we entered into a stock purchase agreement with certain institutional investors, pursuant to which such investors purchased 600,000 of our ordinary shares at a price of $4.80 per share, together with additional investment rights to purchase up to an aggregate of an additional 366,667 ordinary shares at an exercise price of $6.30 per share, for a period of 24 months from August 11, 2004. In addition, we issued an aggregate of $3.0 million principal amount of convertible notes. The convertible notes will mature on July 12, 2007, bear interest at a rate of six month LIBOR plus 2.5% and are convertible at the investors' option at a conversion price of $6.30. The investors also received warrants exercisable for a period of five years beginning on January 12, 2005 to purchase up to an aggregate of 312,500 ordinary shares at an exercise price of $7.50 per share.

On April 6, 2005 we entered into a stock purchase agreement with the same institutional investors, pursuant to which such investors purchased 321,978 of our ordinary shares. In addition, we issued the investors new warrants to purchase an additional 625,000 of our ordinary shares at a purchase price of $6.30 per share for a period of 24 months. As part of this transaction the investors exercised 303,022 additional investment rights that were issued to them in the July 12, 2004 transaction, for the purchase of 303,022 ordinary shares. As a result, we received proceeds of approximately $3,000,000.

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As of December 31, 2006, we owed our Banks $288,000 under long-term loans. $175,000 under a short-term loan and $238,000 under credit facilities.. In addition, our Banks provided $1.4 million of guarantees on our behalf to our customers and suppliers in the ordinary course of business. The guarantees are secured by a first priority floating charge on all our assets and by a fixed charge on goodwill (intangible assets), unpaid share capital and insurance rights (rights to proceeds on insured assets in the event of damage). Our agreements with the Banks prohibit us from selling or otherwise transferring any assets except in the ordinary course of business, from placing a lien on our assets without the Banks' consent and from declaring dividends to our shareholders. In addition, The Israeli Tax Authority has a first priority fixed charge on our fixed assets in the Beit She'an facility. This charge will be released when the litigation between us and our former chief executive officer is resolved.

In addition, on September 1, 2006, we entered into a loan agreement with Mr. Yeung, according to which he provided a $650,000 short-term loan to our company. The purpose of the loan was to provide us with short term working capital. The loan was repaid on November 30, 2006.

We had capital expenditures of $236,000 in 2006 and $411,000 in 2005. We currently do not have any significant capital spending or purchase commitments.

CASH FLOWS

The following table summarizes our cash flows for the periods presented:

	Year ended December 31,	
	2005	2006
	(US dollars in thousands)	
Net cash provided by (used in) operating activities	(5,126)	717
Net cash provided by (used in) investing activities	(750)	71
Net cash provided by (used in) financing activities	2,762	(148)
Net decrease (increase) in cash and cash equivalents	(3,114)	640
Cash and cash equivalents at beginning of the year	3,464	350
Cash and cash equivalents at end of the year	350	990

Net cash generated from operating activities was $717,000 in 2006. This was primarily attributable to our loss of $2.0 million and an increase in inventories of $526,000 offset by a net decrease in costs and estimated earnings in excess of billings of $622,000, a $126,000 increase in accounts payables, accrued expenses, depreciation and amortization of $1.4 million and share-based compensation expenses of $221,000. Net cash used in operating activities was $5.1 million in 2005. This was primarily attributable to our loss of $2.3 million, an increase in trade receivables of $2.7 million, a net increase in costs and estimated earnings in excess of billings of $685,000 and a $568,000 decrease in deferred revenues, offset by a $200,000 decrease in inventories and depreciation and amortization of $1.4 million.

Net cash provided from investing activities was approximately $71,000 in 2006 and $750,000 was used in 2005. In 2006, $313,000 was released from restricted cash and we invested $236,000 in property.. In 2005, we purchased the net assets of Vectop for $351,000 and invested $411,000 in property and equipment.

Net cash used in financing activities was $148,000 in 2006. This amount was principally in respect of our repayment of $ 525,000 of current maturities of long-term loans offset by $288,000 in proceeds from a long term loan. Net cash provided by financing activities was $2.8 million in 2005. This amount was principally in respect of net proceeds of $2.8 million from the issuance of shares and warrants and from the exercise of warrants.

As a result of the foregoing, at December 31, 2006, we had working capital of $3.5 million and cash and cash equivalents of $990,000 as compared to working capital of $3.6 million and cash and cash equivalents of $350,000 at December 31, 2005.

We expect to fund our short-term liquidity needs, including our obligations under our credit facilities, other contractual agreements and any other working capital requirements, from our cash and cash equivalents, operating cash flow and our credit facilities. We believe that our current cash and cash equivalents, credit facilities and our expected cash flow from operations in 2007 will be sufficient to meet our cash requirements in 2007. However, we cannot assure that that such funds will be sufficient to finance our operations. In such event, we expect our shareholders, other investors or the Banks will continue to provide us with funds.

As of March, XX, 2007 there were 5,493,282 warrants outstanding to purchase 5,493,282 of our ordinary shares. Of such warrants, 4,555,782 warrants have an exercise price of $6.00 per share, 625,000 warrants have an exercise price of $6.30 per share and 312,500 warrants have an exercise price of $7.50 per share. To the extent any warrants are exercised, the proceeds will be added to our working capital.

C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

RESEARCH AND DEVELOPMENT

Our research and development investments focus on improvements to our existing products and the development of complementary products that would provide continued support for our current customers and would improve our capability to market our products to new customers.

In 2006 we incurred $181,000 of any research and development expenses. In the years ended December 31, 2004 and 2005, we didn't incur research and development costs. In 2007, we expect that we will continue to enter into new development projects and develop products through customer orders, and we will continue to initiate internally funded research and to invest in existing projects.

As of December 31, 2006, we employed 30 engineers in research and development, which spend most of their time on research and development activities generated through customer orders and an immaterial part of their time on internal research and development activities.

The Office of the Chief Scientist of the Israeli Ministry of Industry and Trade encourages research and development by providing grants to Israeli companies. The terms of such grants prohibit manufacture of the developed products outside Israel and the transfer of technologies developed using the grants to any person without the prior written consent of the Chief Scientist. We have not received any grants from the Office of the Chief Scientist since 1996.

Pursuant to applicable Israeli law, we are currently required to pay royalties at the rate of 3-5% of sales of products developed with certain grants received from the Chief Scientist, up to 100% of the amount of such grants, linked to the U.S. dollar. As of December 31, 2006, our total obligation for royalties payments, net of royalties paid or accrued is approximately $861,000.

We are committed to pay royalties to the Israel - United States Binational Industrial Research and Development Foundation at the rate of 5% of the sales proceeds up to 150% of the research and development expenses financed by the foundation. Our total obligation for royalties, net of royalties paid or accrued, totaled approximately $2.1 million as of December 31, 2006.

D. TREND INFORMATION

In 2005 and 2006 our revenues remained relatively constant. We expect that in 2007 the proportion of sales of off-the-shelf products will continue to increase in comparison to revenues from development programs and that as a result of such change in our product mix, our operating results will improve.

Our future revenues will, in great measure, be dependent upon the success of our sales and marketing strategy. We are currently focusing our sales efforts on:

- Net Centric Digital Recorder (NCDR);
- Ground debriefing stations;
- Optronics; cameras for HUD and armored vehicles;
- Testing solutions
- Manufacturing services.

We cannot provide any assurances that we will be successful in meeting our targets in the future. As a result of the unpredictable business environment in which we operate, we are unable to provide any specific guidance as to sales and profitability trends. If we are unsuccessful in our sales efforts, it is unlikely that we will be able to achieve profitability in the future and we will require additional capital.

E. OFF-BALANCE SHEET ARRANGEMENTS

We are not a party to any material off-balance sheet arrangements. In addition, we have no unconsolidated special purpose financing or partnership entities that are likely to create material contingent obligations.

F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table summarizes our minimum contractual obligations and commercial commitments, as of December 31, 2006 and the effect we expect them to have on our liquidity and cash flow in future periods.

Contractual Obligations	Payments due by Period			
	Total	Less than 1 year	1-3 Years	3-5 Years
Long-term debt obligations	$3,321,000	$3,179,000	$ 142,000	-
Operating lease obligations	$1,306,000	$ 721,000	$ 585,000	-
Total	$4,627,000	$3,900,000	$ 727,000	-

In addition, we have long-term liabilities for severance pay that is calculated pursuant to Israeli severance pay law generally based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. As of December 31, 2006 our severance pay liability was $2,026,000. .

We have attempted to identify additional significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3 - "Key Information."

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

Set forth below are the name, age, principal position and a biographical description of each of our directors and executive officers:

Name	Age	Position
Herzle Bodinger (1)	64	Chairman of the board and president, and chief executive off
Elan Sigal	40	Chief financial officer
Zvi Alon	53	Vice president, business development and marketing
Dov Sella	52	Vice president and chief operating officer
Adrian Berg	59	Director
Roy Kui Chuen Chan	60	Director
Ben Zion Gruber	48	Director
Michael Letchinger	51	Director
Nurit Mor	63	Outside director
Eli Akavia	58	Outside director

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Messrs. Bodinger and Letchinger will serve as directors until our 2007 annual general meeting of shareholders. Mr. Berg will serve as a director until our 2008 annual general meeting of shareholders. Messrs. Chan and Gruber will serve as directors until our 2009 annual general meeting of shareholders.

Ms. Mor and Mr. Akavia will serve as outside directors pursuant to the provisions of the Israeli Companies Law for three-year terms until our 2009 annual general meeting of shareholders. Pursuant to the provisions of the Israeli Companies Law their term may be extended for one additional three-years period.

HERZLE BODINGER joined us in May 1997 as the president of our U.S. subsidiary, Rada Electronic Industries Inc., in charge of international marketing activities and was appointed our president and chief executive officer in June 1998. General (Res.) Bodinger has served as chairman of the board since July 1998. General (Res.) Bodinger served as the Commander of the Israeli Air Force from January 1992 through July 1996. During the last 35 years of his service, he also served as a fighter pilot while holding various command positions. General (Res.) Bodinger holds a B.A. degree in Economics and Business Administration from the Bar-Ilan University and completed the 100th Advanced Management Program at Harvard University.

ELAN SIGAL re-joined us in January 2004 as chief financial officer. From May 2000 to December 2003, Mr. Sigal worked as a management consultant in the London office of McKinsey & Co., a leading global management consulting firm. Prior to that, Mr. Sigal worked with us from July 1997 to April 2000, initially as a system engineer developing one of our leading products, and later as a marketing manager. For nine years Mr. Sigal served as a fighter pilot in the Israeli Air Force. Mr. Sigal holds a B.A. degree in Economics from Tel Aviv University.

ZVI ALON joined us in January 2000 and served as our vice president and chief operating officer until March 30, 2003 when he was appointed vice president of business development and Marketing. From 1980 to 1999 (except for a period from 1987 until 1989), Mr. Alon served in various managerial positions with the Israel Aircraft Industries, as director of business development and marketing, director of electrical and avionics engineering, avionics programs manager and group leader and operational definition officer of the "Lavi" project office. Previously, Mr. Alon served in the Israeli Air Force for ten years. Mr. Alon holds a B.Sc. degree in Mathematics and Computer Science and an M.Sc. degree in Computer Science, both from Tel Aviv University.

DOV SELLA joined us in January 2003 and was appointed chief operating officer on March 30, 2003. Mr. Sella has over 20 years of senior management and product development experience. From 1982 until 1997 Mr. Sella worked for Elbit Systems Ltd., a leading Israeli defense contractor. Among his roles at Elbit were director of programs, director of avionics engineering and director of business development. Between 1997 and 2000, Mr. Sella served UltraGuide Ltd., a medical devices start-up, as executive vice president and vice president of business development and vice president of research and development. During the three years prior to joining our company, Mr. Sella was the president of NeuroVision Inc., a medical technology start-up. Mr. Sella has a B.Sc. degree in Computer Engineering from the Technion Israel Institute of Technology (cum laude). He served as a fighter aircraft navigator in the Israeli Air Force.

ADRIAN BERG has served as a director since November 1997. Mr. Berg is a designee of Horsham Enterprises Ltd. Since 1976, Mr. Berg has been a chartered accountant and senior partner at the U.K. firm, Alexander & Co., Chartered Accountants. Mr. Berg holds a B.Sc. degree in Industrial Administration from the University of Salford and received his qualification as a fellow of the U.K. Institute of Chartered Accountants in 1973 after he completed three years of training at Arthur Andersen & Co.

ROY KUI CHUEN CHAN has served as a director since November 1997. Mr. Chan is a designees of Horsham Enterprises Ltd. Mr. Chan has been legal consultant to Yeung Chi Shing Estates Limited, a Hong Kong holding company with major interests in hotels and real estate in Hong Kong, China, the U.S., Canada and Australia, and its international group of companies, since 1984. Mr. Chan presently serves as legal counsel to several Hong Kong companies, including Horsham Enterprises Ltd. Mr. Chan received his qualification as a solicitor and has been a member of the U.K. bar since 1979 after he completed five years of training at Turners Solicitors.

BEN ZION GRUBER was elected as a director designee of the shareholders (excluding Howard Yeung) that participated in our last private placement. Mr. Gruber is founder and manager of several real estate and construction companies and an entrepreneur involved in several hi-tech companies. Mr. Gruber is a Colonel (Res) of the Israeli Defense Forces serving as Brigadier Commander of a tank battalion. Mr. Gruber holds an M.A. degree in Behavioral Sciences from Tel Aviv University, a B.Sc. degree in Engineering of microcomputers from "Lev" Technology Institute and is currently studying for his PhD degree in Behavioral Sciences at the University of Middlesex, England. In addition Mr. Gruber is a graduate of a summer course in Business Administration at Harvard University, as well as several other courses and training in management, finance and entrepreneurship. Mr. Gruber is a member of the Board of Employment Service of the Government of Israel. He also serves on the boards of directors of the Company for Development of Efrat Ltd., and the Association of Friends of "Kefar Shaul" Hospital. Mr. Gruber serves on the Ethics Committees of the Eitanim and Kefar Shaul Hospitals as well as a director of several other charitable organizations.

MICHAEL LETCHINGER was elected as a director designee of Horsham Enterprises Ltd. in November 2004. Since 2000, Mr. Letchinger has been General Counsel and Senior Vice President-Managing of Potomac Golf Properties, LLC, a company engaged in real estate development and free standing golf facilities. From 1994 to 2000, Mr. Letchinger was General Counsel and Senior Vice President-Managing of Potomac Development Associates, a sister company of Potomac Golf Properties, LLC. Mr. Letchinger holds a B.A. degree in economics from Brandeis University, Waltham, Massachusetts, and a JD from University of Chicago Law School.

NURIT MOR has served as our outside director since August 2006. Ms. Mor has since September 2005 served as an outside director of Aspen Real Estate Ltd. and from May 2004 Ms. Mor has served as an outside director of I.B.I Investment House Ltd., both Israeli public companies. From 1973 to 2003 Ms. Mor served in various positions with the management of the Bank of Israel, including director of public complaints and customer relations. Ms. Mor holds a B.A. degree in Economics and Statistics and an MA in Business Administration from the Hebrew University, Jerusalem, and an M.A degree in Labor Studies form the Tel Aviv University.

ELI AKAVIA has served as our Outside Director since August 2006. Mr. Akavia has since August 2002 served as an independent consultant in accounting and audit issues.. From 1979 to 2002 Mr. Akavia served as partner in various positions in Luboshitz Kasierer, currently a member firm of Ernst & Young International, As of June 2004 Mr. Akavia serves as a director in Eden Springs Ltd., and since December 2003 Mr. Akavia acts as a director in On Track Innovation Ltd. both public Israeli companies. In addition, Mr. Akavia serves as a director in Wintegra Inc. a Delaware corporation. Mr. Akavia has been a Certified Public Accountant (Israel) since 1975 and holds a B.Sc. degree in Mathematics and Economics from the Hebrew University in Jerusalem and an M.B.A degree from the Tel Aviv University.

Adar Azancot ceased to serve as our Chief Executive Officer effective as of August 31, 2006.

B COMPENSATION

The following table sets forth all compensation we paid with respect to all of our directors and executive officers as a group for the year ended December 31, 2006.

	Salaries, fees, commissions and bonuses	Pension, retirement and similar benefits
All directors and executive officers as a group, consisting then of 11 persons	$ 683,100	$ 273,100

During the year ended December 31, 2006, we paid each of our outside directors a per meeting attendance fee of NIS 1,000 ($237) plus an annual fee of NIS 18,000 ($4,260).

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As of December 31, 2006, our directors and executive officers as a group, consisting of eleven persons, held options to purchase an aggregate of 658,001 ordinary shares, at exercise prices ranging from $2.07 to $4.02 per share, vesting over three years. These options were issued under our 2003 Stock Option Plan and expire in 2013. In 2006 200,001 options at exercise price of $2.40 were granted under 2003 plan.

C BOARD PRACTICES

INTRODUCTION

According to the Israeli Companies Law and our Articles of Association, the management of our business is vested in our board of directors. The board of directors may exercise all powers and may take all actions that are not specifically granted to our shareholders. Our executive officers are responsible for our day-to-day management. The executive officers have individual responsibilities established by our chief executive officer and board of directors. Executive officers are appointed by and serve at the discretion of the board of directors, subject to any applicable agreements.

ELECTION OF DIRECTORS

Our articles of association provide for a board of directors consisting of no less than two and no more than eleven members or such other number as may be determined from time to time at a general meeting of shareholders. Our board of directors is currently composed of seven directors.

Pursuant to our articles of association, the board of directors is divided into three classes (other than outside directors). Generally, at each annual meeting of shareholders one class of directors (other than outside directors) is elected for a term of three years by a vote of the holders of a majority of the voting power represented and voting at such meeting. All the members of our board of directors (except the outside directors as detailed below) may be reelected upon completion of their term of office. The majority of directors may appoint additional directors to fill any vacancies in the board of directors until the next general meeting; provided, however that the total number of directors will not exceed the maximum number, if any, fixed by or in accordance with our articles of association, and that if the total number of directors decreases below six, the board of directors may call a general meeting of shareholders, so that following such meeting there will be at least six directors in office.

Messrs. Bodinger and Letchinger are Class B directors and will hold office until the Annual General Meeting of Shareholders to be held in 2007. Mr. Berg is a Class C director and will hold office until the Annual General Meeting of Shareholders to be held in 2008. Messrs. Chan and Gruber are Class A directors and will hold office until the Annual General Meeting of Shareholders to be held in 2009.

Ms. Mor and Mr. Akavia are outside directors and will hold office until our 2009 Annual General Meeting of shareholders.

We do not follow the requirements of the NASDAQ Marketplace Rules with regard to the nomination process of directors and instead follow Israeli law and practice. See below in this Item 6C. "Directors, Senior Management and Employees - Board Practices - NASDAQ Marketplace Rules and Home Country Practices."

OUTSIDE AND INDEPENDENT DIRECTORS

OUTSIDE DIRECTORS. Under the Israeli Companies Law, companies incorporated under the laws of the State of Israel whose shares have been offered to the public are required to appoint at least two outside directors. The Israeli Companies Law provides that a person may not be appointed as an outside director if the person, or the person's relative, partner, employer or an entity under that person's control, has or had during the two years preceding the date of appointment any affiliation with the company, or any entity controlling, controlled by or under common control with the company. The term "relative" means a spouse, sibling, parent, grandparent, child or child of spouse or spouse of any of the above. The term "affiliation" includes an employment relationship, a business or professional relationship maintained on a regular basis, control and service as an office holder, excluding service as an outside director of a company that is offering its shares to the public for the first time.

In addition, no person may serve as an outside director if the person's position or other activities create, or may create, a conflict of interest with the person's responsibilities as director or may otherwise interfere with the person's ability to serve as director. If, at the time an outside director is appointed, all current members of the board of directors are of the same gender, then that outside director must be of the other gender. A director of one company may not be appointed as an outside director of another company if a director of the other company is acting as an outside director of the first company at such time.

As of 2006, at least one of the outside directors elected must have "accounting and financial expertise" and any other outside director must have "accounting and financial expertise" or "professional qualification," as such terms are defined by regulations promulgated under the Israeli Companies Law. This requirement does not apply to outside directors appointed prior to 2006.

Outside directors are elected at our annual general meeting of shareholders. The shareholders voting in favor of their election must include at least one-third of the shares of the non-controlling shareholders of the company who voted on the matter. This minority approval requirement need not be met if the total shareholdings of those non-controlling shareholders who vote against their election represent 1% or less of all of the voting rights in the company. In general, outside directors serve for a three-year term, which may be renewed for only one additional three-year term. Outside directors can be removed from office only by the same special percentage of shareholders as can elect them, or by a court, and then only if the outside directors cease to meet the statutory qualifications with respect to their appointment or if they violate their duty of loyalty to the company.

Any committee of the board of directors must include at least one outside director and the audit committee must include all of the outside directors. An outside director is entitled to compensation as provided in regulations promulgated under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with such service.

INDEPENDENT DIRECTORS. In general, NASDAQ Marketplace Rules require that the board of directors of a NASDAQ-listed company have a majority of independent directors and its audit committee must have at least three members and be comprised only of independent directors, each of whom satisfies the respective "independence" requirements of NASDAQ and the Securities and Exchange Commission. However, foreign private issuers, such as our company, may follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules. We do not follow the requirement of the NASDAQ Marketplace Rules to maintain a majority of independent directors on our board and instead follow Israeli law and practice. See below in this Item 6C. "Directors, Senior Management and Employees - Board Practices - NASDAQ Marketplace Rules and Home Country Practices." However, in accordance with the rules of the Securities and Exchange Commission and NASDAQ, we have the mandated three independent directors, as defined by the rules of the Securities and Exchange Commission and NASDAQ Marketplace, on our audit committee.

Our board of directors has determined that Ms. Nurit Mor and Mr. Akavia both qualify as independent directors under the Securities and Exchange Commission and NASDAQ requirements and as outside directors under the Israeli Companies Law requirements. Our board of directors has further determined that Mr. Gruber qualifies as an independent director under the Securities and Exchange Commission and NASDAQ requirements.

We do not follow the requirements of the NASDAQ Marketplace Rules with regard to regularly scheduled meetings of independent directors. Under Israeli law independent directors are not required to hold executive sessions. See below in this Item 6C. "Directors, Senior Management and Employees - Board Practices - NASDAQ Marketplace Rules and Home Country Practices."

COMMITTEES OF THE BOARD OF DIRECTORS

AUDIT COMMITTEE. Our audit committee, established in accordance with Section 114 of the Israeli Companies Law and Section 3(a)(58)(A) of the Securities Exchange Act of 1934, assists our board of directors in overseeing the accounting and financial reporting processes of our company and audits of our financial statements, including the integrity of our financial statements, compliance with legal and regulatory requirements, our independent public accountants' qualifications and independence, the performance of our internal audit function and independent public accountants, finding any defects in the business management of our company for which purpose the audit committee may consult with our independent auditors and internal auditor, proposing to the board of directors ways to correct such defects, and such other duties as may be directed by our board of directors.

Our audit committee also has the responsibility of approving related-party transactions as required by Israeli law. Under Israeli law, an audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder, unless at the time of approval two outside directors are serving as members of the audit committee and at least one of the outside directors was present at the meeting in which an approval was granted.

Our audit committee is generally authorized to investigate any matter within the scope of its responsibilities and has the power to obtain from our internal auditing unit, our independent auditors or any other officer or employee any information that is relevant to such investigations. Our Audit Committee also has the right to hire independent counsel and accountants to assist it in any investigation that it may instigate.

The current members of our audit committee are Ms. Nurit Mor, and Messrs Eli Akavia and Ben Zion Gruber, each of whom satisfies the respective "independence" requirements of the Securities and Exchange Commission and NASDAQ. We also comply with Israeli law requirements for audit committee members. The audit committee meets at least once each quarter.

COMPENSATION COMMITTEE. Our board of directors established a compensation committee composed of Ms. Nurit Mor and Mr. Adrian Berg. The compensation committee is authorized to determine all compensations issues, including the administration of our option plans subject to general guidelines determined by our board of directors from time to time. The compensation committee will also make recommendations to our board of directors in connection with the terms of employment of our chief executive officer and president.

INTERNAL AUDIT

The Israeli Companies Law also requires the board of directors of a public company to appoint an internal auditor nominated by the audit committee. An internal audit must satisfy the Israeli Companies Law's independence requirements. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business practice. Our internal auditor, complies with the requirements of the Israeli Companies Law.

DIRECTORS' SERVICE CONTRACTS

We do not have any service contracts with our directors. There are no arrangements or understandings between us and any of our subsidiaries, on the one hand, and any of our directors, on the other hand, providing for benefits upon termination of their employment or service as directors of our company or any of our subsidiaries.

APPROVAL OF RELATED PARTY TRANSACTIONS UNDER ISRAELI LAW

The Israeli Companies Law codifies the fiduciary duties that "office holders," including directors and executive officers, owe to a company. An "office holder" is defined in the Israeli Companies Law as a director, general manager, chief business manager, deputy general manager, vice general manager, or any person filling any of these positions in a company even if he or she holds a different title, and also includes any other manager directly subordinate to the general manager. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. An office holder must act at a level of care that a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to utilize reasonable means to obtain (i) information regarding the business feasibility of an action brought for his or her approval or performed by him or her by virtue of his or her position; and (ii) all other important information pertaining to these actions. The duty of loyalty requires that an office holder act in good faith and for the benefit of the company, including the duty to (i) avoid any conflict of interest between the office holder's position in the company and any other position he holds or his personal affairs; (ii) avoid any competition with the company's business; (iii) avoid exploiting any business opportunity of the company in order to obtain benefit for the office holder or any other person; and (iv) disclose to the company any information or documents relating to the company's affairs which the office holder received by virtue of his or her position as an office holder.

The Israeli Companies Law regulates the approval procedures for transaction between a company and its controlling shareholders or transaction in which office holders or the controlling shareholders or their relatives have a personal interest. For the purpose of these requirements a controlling shareholder is defined as a shareholder that holds either solely or in concert with others at least 25% of the issued share capital of the company unless another shareholder holds more than 50% of the issued share capital. The holdings of two or more shareholders, each having a personal interest in the approval of the same transaction are aggregated for this purpose.

Under the Israeli Companies Law, transactions of a company with an office holder and transactions of a company with another entity in which an office holder has a personal interest and which are not extraordinary transactions, must be approved by the board of directors or as otherwise provided for in a company's articles of association. An extraordinary transaction is a transaction other than in the ordinary course of business, other than on market terms, or likely to have a material impact on the company's profitability, assets or liabilities. Extraordinary transactions with an office holder that is not a director and transactions that involve the grant of an exemption, insurance, indemnification or an undertaking to indemnify an office holder that is not a director must be approved by the audit committee and the board of directors. Extraordinary transactions with a director and transactions involving the conclusion of a contract by a company with a director as to the terms of his office, including the grant of an exemption, insurance, indemnification or an undertaking to indemnify, or the conclusion of a contract by a company with a director as to the terms of his employment in other positions, must be approved by the audit committee, board of directors and shareholders. If the office holder is a controlling shareholder or a relative of a controlling shareholder, any extraordinary transaction, compensation, exemption, indemnification and insurance of the office holder must be approved by our audit committee, board of directors and shareholders, supported by the vote of at least one-third of the shares of the non-controlling shareholders voting on the matter, or provided that the total number of shares held by non-controlling shareholders that voted against the proposal did not exceed one percent of all of the voting rights in the company.

The Israeli Companies Law requires that an office holder and a controlling shareholder disclose promptly, and no later than by the first board meeting at which such transaction is considered, any personal interest that he or she may have and all related material information and documents, in connection with any existing or proposed transaction of the company. Personal interest includes any personal interest of the person's relative, or any corporation in which the person or any relative of such person is an interested party. The disclosure requirement does not apply where the office holder or controlling shareholder's personal interest is created only by the personal interest of a relative in a transaction that is not an extraordinary transaction.

A director who has a personal interest in a matter, which is considered at a meeting of the board of directors or the audit committee, may not be present during the discussions of the board of directors or audit committee and may not vote on this matter, unless the transaction under consideration is not an extraordinary transaction or the majority of the members of the board or the audit committee have a personal interest, as the case may be. In the event the majority of the members of the board or the audit committee have a personal interest, then the approval of the general meeting of shareholders is also required.

Under the Companies Regulations (Relief from Related Party Transactions), 5760-2000, promulgated under the Israeli Companies Law, and amended in January 2002, certain transactions between a company and its controlling shareholder(s) do not require shareholder approval. In addition, under such regulations, directors' compensation and employment arrangements do not require the approval of the shareholders if both the audit committee and the board of directors agree that such arrangements only benefit the company or if the directors' compensation does not exceed the maximum amount of compensation for outside directors determined by applicable regulations. Under very limited circumstances, employment and compensation arrangements for an office holder that is a controlling shareholder of the company or his relative do not require the approval of shareholders. The foregoing relief will not apply if one or more shareholders holding at least 1% of the issued and outstanding share capital of the company or of the company's voting rights, objects to the grant of such relief, provided that such objection is submitted to the company in writing not later than fourteen days from the date of the filing of a report regarding the adoption of such resolution by the company. If such objection is duly and timely submitted, then the transaction or compensation arrangement will require shareholders' approval as detailed above.

Board of directors and shareholder approval is also required in the event a company issues its securities in a private placement of securities that will cause a person to become a controlling shareholder, or in the event a private placement in which 20% or more of the company's outstanding share capital prior to the placement are offered, the payment for which (in whole or in part) is not in cash or not under market terms, and that issuance will (i) increase the relative holdings of a shareholder that holds 5% or more of the company's outstanding share capital, or (ii) cause any person to become a holder of more than 5% of the company's outstanding share capital.

Notwithstanding all of the above, if any of the enumerated transactions requiring special approvals is adverse to the company's interest, such approval would not be effective.

EXCULPATION, INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

EXCULPATION OF OFFICE HOLDERS

The Israeli Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to a breach of his or her duty of loyalty. If permitted by its articles of association, a company may exculpate in advance an office holder from his or her liability to the company, in whole or in part, with respect to a breach of his or her duty of care. However, a company may not exculpate in advance a director from his or her liability to the company with respect to a breach of his duty of care in the event of distributions.

INSURANCE OF OFFICE HOLDERS

The Israeli Companies Law provides that a company may, if permitted by its articles of association, enter into a contract to insure office holders in respect of liabilities incurred by the office holder with a respect to an act performed in his or her capacity as an office holder, as a result of:

- a breach of the office holder's duty of care to the company or to another person;
- a breach of the office holder's duty of loyalty to the company, provided that the office holder acted in good faith and had reasonable cause to assume that his or her act would not prejudice the company's interests; or
- a financial liability imposed upon the office holder in favor of another person.

INDEMNIFICATION OF OFFICE HOLDERS

The Israeli Companies Law provides that a company may, if permitted by its articles of association, indemnify an office holder for acts or omissions performed by the office holder in such capacity for:

- a monetary liability imposed on the office holder in favor of another person by any judgment, including a settlement or an arbitrator's award approved by a court;
- reasonable litigation expenses, including attorney's fees, actually incurred by the office holder as a result of an investigation or proceeding instituted against him or her by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any monetary liability in lieu of criminal proceedings, or concluded without the filing of an indictment against the office holder and a monetary liability was imposed on the officer holder in lieu of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent; and

- reasonable litigation expenses, including attorneys' fees, incurred by the office holder or which were imposed on him or her by a court, in an action instituted by the company or on the company's behalf or by another person, against the office holder, or in a criminal charge from which he was acquitted, or in a criminal proceeding in which the office holder was convicted of a criminal offense which does not require proof of criminal intent.

In accordance with the Israeli Companies Law, a company's articles of association may permit the company to:

- prospectively undertake to indemnify an office holder, except that with respect to a monetary liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must be limited to types of events which the company's board of directors deems foreseeable considering the company's actual operations at the time of the undertaking, and to an amount or standard that the board of directors has determined as reasonable under the circumstances.

- retroactively indemnify an office holder of the company.

LIMITATIONS ON EXCULPATION, INSURANCE AND INDEMNIFICATION

The Israeli Companies Law provides that neither a provision of the articles of association permitting the company to enter into a contract to insure the liability of an office holder, nor a provision in the articles of association or a resolution of the board of directors permitting the indemnification of an office holder, nor a provision in the articles of association exculpating an office holder from duty to the company shall be valid, where such insurance, indemnification or exculpation relates to any of the following:

- a breach by the office holder of his duty of loyalty unless, with respect to insurance coverage or indemnification, the office holder acted in good faith and had a reasonable basis to believe that the act would not prejudice the company;

- a breach by the office holder of his duty of care if such breach was committed intentionally or recklessly, unless the breach was committed only negligently.

- any act or omission done with the intent to unlawfully yield a personal benefit; or

- any fine or forfeiture imposed on the office holder.

Pursuant to the Israeli Companies Law, exculpation of, procurement of insurance coverage for, and an undertaking to indemnify or indemnification of, our office holders must be approved by our audit committee and our board of directors and, if the office holder is a director, also by our shareholders.

Our Articles of Association allow us to insure, indemnify and exempt our office holders to the fullest extent permitted by law, subject to the provisions of the Israeli Companies Law. We currently maintain a directors and officers liability insurance policy with a per claim and aggregate coverage limit of $5.0 million. However, at an annual general meeting of our shareholders held on June, 2005, our shareholders approved an increase of the aggregate coverage limit to $10.0 million provided that the annual premium will not exceed $150,000.

NASDAQ MARKETPLACE RULES AND HOME COUNTRY PRACTICES

Under NASDAQ Marketplace Rule 4350, or Rule 4350, foreign private issuers, such as our company, are permitted to follow certain home country corporate governance practices instead of certain provisions of Rule 4350. A foreign private issuer that elects to follow a home country practice instead of any of such provisions of Rule 4350, must submit to NASDAQ, in advance, a written statement from an independent counsel in such issuer's home country certifying that the issuer's practices are not prohibited by the home country's laws.

In May and August 2005, we provided NASDAQ with a notice of non-compliance with Rule 4350. We informed NASDAQ that we do not comply with the following requirements of Rule 4350, and instead follow Israeli law and practice in respect of such requirements:

- the requirement to maintain a majority of independent directors, as defined under the NASDAQ Marketplace Rules. Instead, under Israeli law and practice, we are required to appoint at least two outside directors, within the meaning of the Israeli Companies Law, to our board of directors. In addition, in accordance with the rules of the Securities and Exchange Commission and NASDAQ, we have the mandated three independent directors, as defined by the rules of the Securities and Exchange Commission and NASDAQ, on our audit committee. See above in this Item 6C. "Directors, Senior Management and Employees - Board Practices - Independent and Outside Directors.

- the requirement that our independent directors will have regularly scheduled meetings at which only independent directors are present. Under Israeli law independent directors are not required to hold executive sessions.

- the requirement regarding the directors nominations process. Instead, we follow Israeli law and practice in accordance with which our directors are recommended by our board of directors for election by our shareholders. See above in this Item 6C. "Directors, Senior Management and Employees - Board Practices - Election of Directors."

- the requirement regarding compensation of officers. Instead, we follow Israeli law and practice. Under the Israeli Companies Law, all arrangements as to compensation of office holders who are not directors require the approval of the board of directors if the transaction is not an "extraordinary transaction," unless a company's articles of association provide otherwise, and if such transaction is an "extraordinary transaction," it requires the approval of the audit committee and the board of directors, in that order. The compensation of office holders who are directors must be approved by our Audit Committee, Board of Directors and shareholders, in that order.

D. EMPLOYEES

On December 31, 2006, we employed 97 persons, of whom 30 were employed in research, development and engineering, 55 persons in manufacturing and logistics, 5 persons in sales and marketing, and 7 persons in administration and management and finance. All of our employees are located in Israel. In addition, CACS (our 80% owned subsidiary) employed 15 persons in China.

On December 31, 2005, we employed 109 persons, of whom 38 were employed in research, development and engineering, 56 persons in manufacturing and logistics, 5 persons in sales and marketing, and 10 persons in administration and management and finance. All of our employees are located in Israel. In addition, CACS (our 80% owned subsidiary) employed 15 persons in China.

On December 31, 2004, we employed 106 persons, of whom 41 were employed in research, development and engineering, 51 persons in manufacturing and logistics, 4 persons in sales and marketing, and 10 persons in administration and management and finance. All of our employees are located in Israel. In addition, CACS (our 80% owned subsidiary) employed 18 persons in China.

Our technical employees have signed nondisclosure agreements covering all proprietary information that they might possess or to which they might have access. Employees are not organized in any union, although they are employed according to provisions established by the Israeli Ministry of Labor. Certain provisions of the collective bargaining agreements between the Histadrut

(General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Industrialists Association) are applicable to our Israeli employees by order of the Israeli Ministry of Labor. These provisions concern mainly the length of the workday, minimum daily wages for professional workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. We generally provide our employees with benefits and working conditions beyond the required minimums. Under the collective bargaining agreements, the wages of most of our employees are linked to the Israeli consumer price index, although the extent of the linkage is limited.

Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment without due cause. Further, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute which is similar to the United States Social Security Administration, such amounts also include payments for national health insurance. Most of our ongoing severance obligations for our Israeli employees are provided for by monthly payments made by us for insurance policies to cover these obligations.

E. SHARE OWNERSHIP

BENEFICIAL OWNERSHIP OF EXECUTIVE OFFICERS AND DIRECTORS

The following table sets forth certain information as of March 26, 2007 regarding the beneficial ownership by each of our directors and executive officers:

NAME	Number of Ordinary Shares Beneficially Owned (1)	Percentage of Ownership(2)
Herzle Bodinger (3)...........................	100,000	1.1%
Elan Sigal (3)(4)	55,555	*
Zvi Alon (3)(5)	55,555	*
Dov Sella (3)(5)	55,555	*
Adrian Berg (6)(7)	85,533	1.0%
Roy Kui Chuen Chan (8)(9)	58,867	*
Ben Zion Gruber (3)(10)	84,694	1.0%
Michael Letchinger (11)	-	-
Nurit Mor (3)	-	-
Eli Akavia (3)	-	-
All directors and executive officers as a group (10) persons)(12)	495,759	5.7%

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* Less than 1%

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options and warrants currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for

computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 8,728,509 ordinary shares issued and outstanding as of March 26, 2007.

(3) The business addresses of Messrs. Bodinger, Azancot, Sigal, Alon, Sella, Gruber, Akavia and Ms. Mor is c/o RADA Electronic Industries Ltd., 7 Giborei Israel Street, Netanya, Israel.

(4) All such ordinary shares are subject to currently exercisable options granted under our 2003 stock option plan. 22,222 options at an exercise price of $2.40 per share and 33,333 options at an exercise price of $3.87 per share . The options expire in September 2013.

(5) All such ordinary shares are subject to currently exercisable options granted under our 2003 stock option plan. 33,333 options at an exercise price of $2.07 per share and 22,222 options at an exercise price of $2.40 per share. The options expire in September 2013.

(6) The business address of Mr. Berg is Alexander & Co., 17 St. Ann's Square, Manchester M2 7 PW, U.K.

(7) Includes 84,000 ordinary shares subject to currently exercisable options granted under our stock option plan at an exercise price of $4.02 per share. The options expire in September 2013.

(8) The business address of Mr. Chuen Chan is Gearhart Holdings (H.K.) Limited, 2202 Kodak House II, 39 Healthy Street, E. North Point, Hong Kong.

(9) Includes 57,333 ordinary shares subject to currently exercisable options granted under our stock option plan at an exercise price of $4.02 per share. The options expire in September 2013.

(10) Includes 68,027 ordinary shares issuable upon currently exercisable warrants at an exercise price of $6.00 per share that were issue in connection with the private placement of our shares in June 2002, and 16,667 ordinary shares subject to currently exercisable options granted under our stock option plans, at an exercise price of $4.02 per share. Such options expire in September 2013.

(11) The business address of Mr. Letchinger is 2709 Rittenhouse Street, Washington DC, 20015, USA.

(12) Includes 68,027 ordinary shares issuable upon the exercise of currently exercisable warrants, at an exercise price of $6 per share that were issued in connection with a private placement of our shares in June 2002. Such warrants expire on June 30, 2007.

STOCK OPTION PLANS

1999 STOCK OPTION PLAN

Our 1999 Stock Option Plan, or the 1999 Plan, provides for the issuance of stock options to purchase an aggregate of 108,400 of our ordinary shares.

The1999 Plan, authorizes the issuance of options to key employees and consultants, including officers and directors of our company and its subsidiaries, who, are in position to contribute significantly to our success, in the judgment of the board of directors or, if appointed in the future, a committee which will administer the 1999 Plan. The board of directors or the committee will determine the number of shares covered by each option, and the formulation, within the limitations of the 1999 Plan, of the form of option

Options granted under the 1999 Plan may be for a maximum term of ten years from the date of grant. The exercise price of an option granted to an employee may not be less than 60% of the fair market value of our ordinary shares on the date of grant of the option. The exercise price of an option to a non-employee director or consultant may not be less than 80% of the fair market value of our ordinary shares on the date of grant of the option. If any option expires without having been fully exercised, the shares with respect to which such option has not been exercised will be available for future grants.

Options may not be transferable by the optionee otherwise than by will or the laws of descent and distribution and during the optionee's lifetime are exercisable only by the optionee. Options terminate before their expiration dates one year after the optionee's death while in our employ, three months after the optionee's retirement for reasons of age or disability or involuntary termination of employment other than for cause, and immediately upon voluntary termination of employment or involuntary termination of employment for cause.

Our board of directors may, at its discretion, modify, revise or terminate the 1999 Plan at any time, except that the aggregate number of shares issuable pursuant to options may not be increased (except in the event of certain changes in our capital structure), the eligibility provisions and minimum option price may not be changed, or the permissible maximum term of options may not be increased without the consent of our shareholders.

The 1999 Plan also contains provisions protecting optionees against dilution of the value of their options in the case of stock splits, stock dividends or other changes in our capital structure, in the event of any proposed reorganization or merger involving our company or in the event of any spin-off or distribution of assets to our shareholders.

As of March 26, 2007, options to purchase 81,633 ordinary shares had been granted to 30 employees at an average exercise price of $6.51 per share. All of such options are currently exercisable.

2003 STOCK OPTION PLAN

Our 2003 Stock Option Plan, or the 2003 Plan, provides for the issuance of stock options to purchase an aggregate of 666,667 of our ordinary shares. At the Company's Annual General meeting held in August, 2006, shareholder approve a 500,000 share increase in the number ordinary shares available for grant under the plan. Consequently, 1,166,667 shares are subject to this plan. Options under the 2003 Plan may be issued to employees including officers and directors of our company and its subsidiaries who, in the judgment of the board of directors based on the recommendation of our compensation committee, are in a position to contribute significantly to our success. The provisions of our 2003 Plan are designated to allow for the tax benefits promulgated under the Israeli Income Tax Ordinance [New Version]. Our board of directors has resolved that all options that will be granted to Israeli residents under the 2003 Plan will be taxable under the "capital gains path." Pursuant to this path the profit realized by the employee is taxed as a capital gain (25%) if the options or shares are held by a trustee for at least 24 months from the end of the tax year in which such options were granted. If the shares are sold before the lapse of said 24 months period, the profit is re-characterized as ordinary income. The company is not allowed a corresponding salary expense, even in the event the profit is taxed as ordinary income. Otherwise, the terms of the 2003 Plan are substantially the same as those of the 1999 Plan.

As of March 26, 2007 options to purchase 1,191,000 ordinary shares had been granted. Of such options, 51,168 options have been exercised and 80,666 have been cancelled or forfeited. 1,059,166 options are outstanding. Options to purchase 705,722 ordinary shares are currently exercisable.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS

Mr. Howard Yeung is the beneficial holder of 46% of our outstanding shares, and holds currently exercisable warrants to purchase an additional 2,755,102 of our ordinary shares. Accordingly, Mr. Howard Yeung may be deemed to control our company.

The following table sets forth certain information as of March 26, 2007, regarding the beneficial ownership by all shareholders known to us to own beneficially 5% or more of our ordinary shares:

Name	Number of Ordinary Shares Beneficially Owned(1)	Percentage of Ownership(2)
Howard P.L. Yeung (3)(4)(5)	6,802,620	59.2%
Kenneth Yeung (3)(6)	450,029	5.2%
Iroquuois Capital LLP (7)(8)	496,016	5.4%
Smithfield Fiduciary LLC (9)(10) ...	570,397	6.2%

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Ordinary shares relating to options currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 8,728,509 ordinary shares outstanding as of March 26, 2007.

(3) Of the 6,802,620 ordinary shares, 450,029 shares are held by Horsham Enterprises Ltd., a corporation incorporated in the British Virgin Islands. Messrs. Howard P.L. Yeung and his brother Kenneth Yeung are the beneficial owners, in equal shares, of Horsham Enterprises Ltd. Accordingly, Messrs. Yeung may be deemed to be the beneficial owners of the ordinary shares held by Horsham Enterprises Ltd.

(4) Includes 2,755,102 ordinary shares issuable upon the exercise of currently exercisable warrants issued to Mr. Howard P.L. Yeung.

(5) The address of Mr. Howard P.L. Yeung is 2202 Kodak House II, 39 Healthy Street, North Point, Hong Kong.

(6) The address of Mr. Kenneth Yeung is 2202 Kodak House II, 39 Healthy Street, North Point, Hong Kong.

(7) Includes 72,917 ordinary shares issuable upon currently exercisable warrants at an exercise price of $7.50 per share and 111,111 ordinary shares issuable upon currently exercisable convertible notes that were issued in connection with the private placement of our shares in July 2004. In addition, 210,086 ordinary shares issuable upon currently exercisable warrants at an exercise price of $6.30 per share that was issued in connection with the private placement of our shares in April 2005.

(8) The address of Iroquois Capital LLP is 641 Lexington Ave., 26th Floor, New York, New York, 10022.

(9) Includes 133,333 ordinary shares issuable upon currently exercisable warrants at an exercise price of $7.50 per share and 203,175 ordinary shares issuable upon currently exercisable convertible notes that were issued in connection with the private placement of our shares in July 2004. In addition, 157,514 ordinary shares issuable upon currently exercisable warrants at an exercise price of $6.30 per share that was issued in connection with the private placement of our shares in April 2005.

(10) The address of Smithfield Fiduciary LLC is c/o Highbridge Capital Management LLC, 9 West 57th Street, 27th Floor, New York, New York 10019.

SIGNIFICANT CHANGES IN THE OWNERSHIP OF MAJOR SHAREHOLDERS

On January 27, 2005, Bank Leumi le-Israel B.M, filed a Schedule 13G with the Securities and Exchange Commission reflecting ownership of 976,399, or 13.7%, of our ordinary shares. In an amendment to the Schedule 13G filed with the Securities and Exchange Commission on June 6, 2005, Bank Leumi le-Israel B.M reported ownership of 220,000, or 2.9%, of our ordinary shares.

MAJOR SHAREHOLDERS VOTING RIGHTS

Our major shareholders do not have different voting rights.

RECORD HOLDERS

Based on a review of the information provided to us by our transfer agent, as of March 28, 2007, there were 309 holders of record of our ordinary shares, of which 283 record holders holding approximately 28% of our ordinary shares had registered addresses in the United States, including banks, brokers and nominees. These numbers are not representative of the number of beneficial holders of our shares nor are they representative of where such beneficial holders reside, since many of these ordinary shares were held of record by banks, brokers or other nominees

B. RELATED PARTY TRANSACTIONS

On June 22, 2003 we signed a memorandum of agreement with Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M., or the Banks, which agreement was approved by our shareholders at an extraordinary general meeting of shareholders that was held on July 22, 2003. Pursuant to the agreement that was finalized on September 24, 2003, we restructured $3,451,000 of our outstanding debt to the Banks. We repaid $1,100,000 on account of our debt the Banks, and the Banks forgave

$1,100,000 of debt and received warrants to purchase 1,260,665 of our ordinary shares, at an exercise price that is equal to the nominal (par) value of our shares, in lieu of $1,251,000 of our debt. The Banks also agreed to grant us an additional short-term line of credit of $500,000 to finance our cash flow requirements during 2003. As part of the agreement, our controlling shareholder, Mr. Yeung, agreed to grant the Banks a put option allowing the Banks to require him to purchase the above warrants for the consideration of $1,251,000, exercisable within a period of 45 days commencing on March 24, 2005 and the Banks granted Mr. Yeung a call option allowing him to require the Banks, during a period of 18 months, commencing as of September 24, 2003, and in the event that the Banks do not exercise their put option, during an additional 90 day period commencing as of May 9, 2005, to sell him such warrants at a price that is not lower than $1,251,000 and not higher then $1,770,165, depending upon the average close price of our ordinary shares during the 90 business days prior to such exercise. We also granted the Banks warrants to purchase an additional 366,667 ordinary shares at an exercise price of $6.00 per share, exercisable for five years, commencing as of September 24, 2003.

In May 2005, Mr. Yeung exercised his call option to purchase the warrants from the Banks and in October 2005 exercised these warrants. Upon such exercise, we issued 1,260,665 ordinary shares, to Mr. Yeung.

C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

LEGAL PROCEEDINGS

ALL PROCEEDINGS DESCRIBED HEREUNDER, IN WHICH WE OR OUR OFFICE HOLDERS ARE INVOLVED, AGAINST MR. H. NISSENSON, OUR FORMER PRESIDENT, OR MR. E. DUBRONSKY, A FORMER BOARD MEMBER, ARE THE SUBJECT OF MEDIATION PROCESS WHICH IS CURRENTLY ONGOING. AS A RESULT, ALL SUCH PROCEEDINGS, EXCEPT THOSE IN THE REGIONAL LABOR COURT IN TEL-AVIV, HAVE BEEN STAYED, PENDING THE OUTCOME OF THE MEDIATION PROCESS.

In December 1998, Mr. Haim Nissenson, our former president and chief executive officer, filed a complaint against us and Mr. Herzle Bodinger, our president, in the Regional Labor Court of Tel Aviv (Case No. 3/4074/98 H. NISSENSON V. RADA ELECTRONIC INDUSTRIES LTD. AND OTHERS), seeking approximately NIS 2.0 million (approximately $440,000) for salary, vacation and severance payments and other benefits that he is allegedly entitled to pursuant to his retirement agreement with us. In addition, Mr. Nissenson is seeking a permanent injunction and a declarative relief, stating that a personal loan that was provided to him by us had been forgiven. Mr. Nissenson is also asserting that Mr. Bodinger caused the breach of the retirement agreement. In response, we filed a statement of defense claiming, among other things, that (i) the retirement agreement is not valid since it was not approved pursuant to the requirements of the applicable law; (ii) Mr. Nissenson was responsible for our company's precarious financial condition at the time he resigned and for the concealment of these facts from our board of directors and our investors; (iii) during the board of directors meeting in which such agreement was discussed and approved, Mr. Nissenson misrepresented our financial and economic condition and the nature and origins of his debt to us; and (iv) by breaching his fiduciary duties Mr. Nissenson caused us damages in amounts that exceed the amount of the complaint, which damages should be offset from any amounts awarded in favor of Mr. Nissenson, if any. In addition, we asserted that in a certificate dated March 23, 1992, Mr. Nissenson assigned to us all his rights to receive employment related benefits other than salaries, including severance and vacation payments for the period up to the certificate date. The hearing of this claim was combined with the hearing of our claim for repayment of the loan granted to Mr. Nissenson, as detailed below. The hearing of testimony in this matter was recently concluded. Our management believes that this claim will not have a material adverse effect on our financial condition or results of operations. In addition, the income tax authorities have demanded that we commence payment of the salary tax due in respect of the retirement arrangements of Mr. Nissenson which are the subject matter of this litigation. An agreement was reached with the tax authority whereby the tax liability will be discharged over several years and that in the event that Mr. Nissenson's claim is dismissed, the tax payment will be recovered.

In September 1999, we filed a suit in the District Court of Tel-Aviv against Messrs. Haim Nissenson and Eles Dubronsky (Civil File 2514/99 RADA ELECTRONIC INDUSTRIES LTD. V. H. NISSENSON AND OTHERS) seeking damages in the amount of $1.4 million. In the complaint, we alleged that Messrs. Nissenson and Dubronsky: (i) represented to our board of directors inaccurate and incomplete information, and (ii) failed to disclose, during the course of our board's deliberations to acquire Jetborne International, Ltd., their personal interest in Jetborne International and Mr. Nissenson's involvement in a previous attempt to gain control of Jetborne International several years earlier. We alleged that our board of directors approved the acquisition based on such inaccurate and incomplete information and that the acquisition caused severe losses. We further alleged that in their conduct Messrs. Nissenson and Dubronsky breached their fiduciary duty owed to us and to our shareholders while acting as an executive and members of our board of directors. Our motion to attach the funds deposited by Mr. Nissenson in his pension funds was denied by the Court in May 2000. The suit is still in its preliminary stages.

In January 2000, Vertical Integration Limited filed a claim against us with the District Court of Tel Aviv (Case No. 1120/00 VERTICAL INTEGRATION LIMITED V. RADA ELECTRONIC INDUSTRIES LTD) for the amount of $250,000. It was alleged that at the beginning of 1997, they entered into an agreement with us, whereby they were entitled to remuneration in the event that they found an investor for our company. The claim was dismissed by the Court and it was held, inter alia, that the witnesses for the plaintiffs were not credible. The plaintiffs appealed to the Supreme Court and the matter is now pending. We believe that there will be no material exposure or adverse effect on our financial condition as a result of this appeal.

In August 2000, we filed a claim against Mr. Haim Nissenson in the Regional Court for Labor Disputes in Tel Aviv (Case No. 7049/00 RADA ELECTRONIC INDUSTRIES LTD. V. NISSENSON.) for the amount of NIS 2.0 million (approximately $440,000) for the repayment of the loan granted by us to Mr. Nissenson that allegedly was forgiven by us in Mr. Nissenson's retirement agreement, as mentioned above. The hearings of both Mr. Nissenson's and our claims in the Regional Court for Labor Disputes were joined and the court has recently completed hearing the testimony of our witnesses.

In January 2001, we filed a suit against our former controller, Mr. Mordechai Perera in the Regional Court for Labor Disputes in Tel Aviv (Case No. 1672/01 RADA ELECTRONIC INDUSTRIES LTD. V. PERERA) in the amount of approximately $260,000 for the repayment of a loan provided to him. While Mr. Perera did not deny that he received such amount, he argued that it was promised to him on account of his compensation and was registered as a loan in the books of our company for tax purposes. He further claimed that Mr. Nissenson orally promised him that such loan would be forgiven. In March 2001, Mr. Perera filed a counter claim in the amount of approximately $520,000 for various payments to which he was allegedly entitled in connection with his employment and termination thereof by us, including bonus, severance payments, vacation redemption and overtime payments. In December 2006 a judgment was delivered by the Court, whereby Perera's counter-claim was dismissed entirely and our claim was allowed in part, as the Court held that we have waived half of Perera's debt. We have recently appealed to the National Labor Court and the matter is pending there.

In February 2001, we filed a suit against Mr. Dubronsky, in the District Court of Tel Aviv (Civil Case 1158/01 RADA ELECTRONIC INDUSTRIES LTD. V. E. DUBRONSKY) seeking approximately $250,000. We maintain that Mr. Dubronsky is personally responsible for drafting and executing Mr. Nissenson's retirement agreement and that in such capacity he breached his fiduciary duties to our company and should the Labor Court decide that the retirement agreement is valid and enforceable against us, Mr. Dubronsky has to indemnify us for all the damages caused to us as a result of such Court decision. The District Court has issued a stay of the proceedings pending resolution of the Labor Court proceedings detailed above.

In May 2001, Mr. Haim Nissenson filed a suit against us in the District Court of Tel Aviv (Civil Case 1715/01 H. NISSENSON V. RADA ELECTRONIC INDUSTRIES LTD.) for damages allegedly suffered by him as a result the cancellation of an attachment imposed by us on his pension funds in connection with the previously mentioned Jetborne International litigation. The claim is for NIS 1.0 million (approximately $220,000). In response, we filed a statement of defense denying all of Mr. Nissenson's allegations.

In May 2001, Mr. David Kenig, a former member of our board of directors, filed a claim against us in the District Court of Tel Aviv (Civil Case 1791/01 KENIG V. RADA ELECTRONIC INDUSTRIES LTD.) seeking a declaration that he is entitled to receive options to purchase 200,000 of our ordinary shares (after the reverse split) under the same terms and conditions as those granted by us to other directors in 1999, and an injunction enforcing us to issue such options to him. Based on legal advice, we believe that the claim has no merits. In July 2001 we filed a counter-claim in the amount of NIS 500,000. In the counter-claim we maintain that Mr. Kenig is personally responsible for executing Mr. Nissenson's retirement agreement and that in such capacity he breached his fiduciary and care duties towards us and should the Labor Court decide that the retirement agreement is valid and enforceable against us, then Mr. Kenig has to indemnify us for all the damages caused to us as a result of such Labor Court decision. The District Court has issued a stay of the hearings pending resolution of the Labor Court proceedings detailed above.

In June 2001, we filed a counter claim (within the framework of the said civil case 1715/01) against Mr. Haim Nissenson, his wife and another former director for damages caused us as a result of transfers of funds to third parties that were made in breach of fiduciary duties owed to us by Mr. Nissenson and the other former director. In addition, we are seeking a declaratory judgment stating that Mrs. Nissenson is liable to us for the repayment of the loan provided to Mr. Nissenson, jointly with Mr. Nissenson. We are also seeking a declaration that the transfer of the title to Mr. Nissenson's house and another apartment to his wife without consideration in the beginning of 1997 are void and were made to avoid the repayment of outstanding loans to us.

In August 2004, Mr. Nissenson filed a suit against us, and our office holders, Messers. Bodinger, Azancot, Agmon, Tropp, Sigal and Ms. Snir and against our former chief financial officer, Mr. Ronen Stein, in the Magistrate Court of Tel Aviv (CIVIL CASE 56365/04 NISSENSON V. RADA ELECTRONIC INDUSTRIES LTD. AND OTHERS), seeking damages in the amount of NIS 1.0 million (approximately $220,000) and alleging that the description of the claim filed against him and another former director in connection with the acquisition of our formerly owned subsidiary Jetborne International, Ltd. included in our annual reports on Form 20-F and certain press releases contains defamatory allegations with respect to Mr. Nissenson. We believe that we and our officers have valid defenses against these claims. According to Israeli law, the usual award in defamatory claims is low and does not exceed NIS 500,000 (approximately $110,000).

In June 2005, Mr. Nissenson filed a suit in the District Court of Tel Aviv against our chairman, Mr. Bodinger (Civil Case No. 1845/05 H. NISSENSON V. H. BODINGER) seeking damages in an amount of NIS 2.6 million (approximately $565,000). In the complaint, which was filed with the court one day before the expiration of the statute of limitations , Mr. Nissenson alleged that Mr. Bodinger committed fraud against him and negligent misrepresentation towards him, as a result of which he was compelled at the time (June 1998), to retire from his position as the chief executive officer of our company. Mr. Nissenson further alleged that Mr. Bodinger represented to our board of directors that Boeing Corporation would not invest in our company unless Mr. Nissenson retired from his position as the chief executive officer. It is further alleged that as a result, Mr. Nissenson retired from his position, losing income equal to the claimed amount of NIS 2.6 million. In response, we filed a statement of defense, claiming among other things, that no representation whatsoever was made by Mr. Bodinger to the board of directors and that Mr. Nissenson was fully aware, at all times, of all the relevant information regarding the possibility of the investment by Boeing Corporation. We further asserted that the allegation raised by Mr. Nissenson in this claim is inconsistent with his allegation in his claim against us in the Regional Court for Labor Dispute (Case No. 3/4074/98) and that there is no sufficient legal basis for his claim. Our management believes that this claim (in respect of which Mr. Bodinger is entitled to indemnity from us), does not carry any material exposure or adverse effect on our financial condition.

In May 2006, Mr. Nissenson filed a suit in the Magistrates Court of Tel-Aviv against our Board Members, Mr. R. K. C. Chan and Mr. A.H. Berg (C.C. 29334/06 NISSENSON VS. CHAN AND BERG) seeking damages in the amount of NIS. 0.5 Million (approx. $110,000). In essence, this claim is identical to Mr. Nissenson' claim against us and against our officer holders (C.C. 56365/04 in the Magistrates Court of Tel-Aviv) which is described above. A response has not as yet been submitted on behalf of the defendants, since the issue of the competency of the Court has to be decided first.

In 2006, we filed a suit before an Arbitrator seeking to recover $444,574 from Parado Technologies Ltd., formerly known as Vectop Ltd. ("Vectop"). On the same day Vectop counterclaimed against us seeking an order that we transfer an amount of $181,492 to a trust account and to provide Vectop an accounting of sales made during 2006. These claims are related to an agreement made with Vectop in 2005 whereby we purchased certain of Vectop's assets. Under the Agreement, Vectop is entitled to receive payments contingent upon sales made by us of Vectop's products. According to the Agreement, the first $200,000 due to Vectop should have been transferred to a trust account for the purpose of indemnifying us for possible future damages. In our claim, we assert that we are entitled to compensation because of misrepresentations made by Vectop during the negotiations, in connection with five of the products sold to us by Vectop. We also allege that Vectop breached the agreement by not providing on time financial statements reconciled to US GAAP. We also asserted that we have a right of set-off against payments due to Vectop under the Agreement. Vectop alleges that we are obliged to transfer to the trust account the part of the immediate payment from the sales of the year 2005 and that we can only be indemnified from this trust account under a final award of the Arbitrator. We believe that there is a possibility that the Arbitrator will order the transfer of the said amount to the trust account until a final award is delivered. As for the outcome of the arbitration, the matter is still in its early stages and we are therefore unable to assess the possibility that Vectop's claim will be allowed.

From time to time we are involved in legal proceedings arising from the operation of our business. Based on the advice of our legal counsel, management believes such other current proceedings will not have a material adverse effect on our financial position or results of operations.

DIVIDEND DISTRIBUTION POLICY

We have never paid cash dividends to our shareholders. We intend to retain future earnings for use in our business and do not anticipate paying cash dividends on our ordinary shares in the foreseeable future. Any future dividend policy will be determined by the board of directors and will be based upon conditions then existing, including our results of operations, financial condition, current and anticipated cash needs, contractual restrictions and other conditions as the board of directors may deem relevant.

According to the Israeli Companies Law, a company may distribute dividends out of its profits, so long as the company reasonably believes that such dividend distribution will not prevent the company from paying all its current and future debts. Profits, for purposes of the Israeli Companies Law, means the greater of retained earnings or earnings accumulated during the preceding two years. In the event cash dividends are declared, such dividends will be paid in NIS.

B. SIGNIFICANT CHANGES

Since the date of the annual consolidated financial statements included in this annual report, no significant changes have occurred.

ITEM 9. THE OFFER AND LISTING

A. OFFER AND LISTING DETAILS

ANNUAL STOCK INFORMATION

The following table sets forth, for each of the years indicated, the range of high ask and low bid prices of our ordinary shares on the NASDAQ National Market or the NASDAQ Capital Market:

Year	High	Low
2002	$ 5.40	$ 1.65
2003	6.69	1.65
2004	10.32	3.42
2005	5.64	3.18

2006	3.9	1.95

QUARTERLY STOCK INFORMATION

The following table sets forth, for each of the full financial quarters in the years indicated, the range of high ask and low bid prices of our ordinary shares on the NASDAQ Capital Market:

2005	High	Low
First Quarter	$ 5.64	$ 4.38
Second Quarter	5.22	3.87
Third Quarter	4.56	3.75
Fourth Quarter	3.99	3.18

2006	High	Low
First Quarter	$ 3.9	$ 2.79
Second Quarter	2.85	1.95
Third Quarter	3.03	2.16
Fourth Quarter	2.67	1.98

MONTHLY STOCK INFORMATION

The following table sets forth, for the most recent six months, the range of high ask and low bid prices of our ordinary shares on the NASDAQ Capital Market:

2006	High	Low
October	$ 2.67	$ 2.34
November	2.43	2.1
December	2.19	1.98
2007		
January	$ 3.00	$ 1.95
February	2.55	1.98
March (through March 28, 2007)	2.94	2.01

B. PLAN OF DISTRIBUTION

Not applicable.

C. MARKETS

Our ordinary shares traded on the NASDAQ National Market under the symbol "RADIF" from 1985 until June 10, 2002 when the listing of our ordinary shares was transferred to the NASDAQ Capital Market. On December 13, 2005, we changed our symbol to "RADI." , which symbol was changed for a 22 business day period to RADID after our reverse split on February 14, 2007. On March 15, 2007, we changed our symbol to "RADA."

D. SELLING SHAREHOLDERS

Not applicable.

E. DILUTION

Not applicable.

F. EXPENSE OF THE ISSUE

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL

Not applicable.

B. MEMORANDUM AND ARTICLES OF ASSOCIATION

PURPOSES AND OBJECTS OF THE COMPANY

We are registered with the Israeli Companies Registry and have been assigned company number 52-003532-3. Section 2 of our memorandum of association provides that we were established for the purpose of engaging in the business of providing services of planning, development, consultation and instruction in the electronics field. In addition, the purpose of our company is to perform various corporate activities permissible under Israeli law.

On February 1, 2000, the Israeli Companies Law came into effect and superseded most of the provisions of the Israeli Companies Ordinance (New Version), 5743-1983, except for certain provisions which relate to liens, bankruptcy, dissolution and liquidation of companies. Under the Israeli Companies Law, as recently amended, various provisions, some of which are detailed below, overrule the current provisions of our articles of association.

THE POWERS OF THE DIRECTORS

Under the provisions of the Israeli Companies Law, and our articles of association, a director cannot participate in a meeting nor vote on a proposal, arrangement or contract in which he or she is materially interested. In addition, our directors cannot vote compensation to themselves or any members of their body without the approval of our audit committee and our shareholders at a general meeting. See "Item 6A. Directors, Senior Management and Employees - Approval of Related Party Transactions Under Israeli Law."

The authority of our directors to enter into borrowing arrangements on our behalf is not limited, except in the same manner as any other transaction by us.

Under our articles of association, retirement of directors from office is not subject to any age limitation and our directors are not required to own shares in our company in order to qualify to serve as directors.

RIGHTS ATTACHED TO SHARES

Our authorized share capital consists of 16,333,333 ordinary shares of a nominal value of NIS 0.015 each. All outstanding ordinary shares are validly issued, fully paid and non-assessable. The rights attached to the ordinary shares are as follows:

The rights attached to the ordinary shares are as follows:

DIVIDEND RIGHTS. Holders of our ordinary shares are entitled to the full amount of any cash or share dividend subsequently declared. The board of directors may declare interim dividends and propose the final dividend with respect to any fiscal year only out of the retained earnings, in accordance with the provisions of the Israeli Companies Law. Our articles of association provide that the declaration of a dividend requires approval by an ordinary resolution of the shareholders, which may decrease but not increase the amount proposed by the board of directors. See "Item 8A. Financial Information - Consolidated and Other Financial Information - Dividend Distribution Policy." If after one year a dividend has been declared and it is still unclaimed, the board of directors is entitled to invest or utilize the unclaimed amount of dividend in any manner to our benefit until it is claimed. We are not obligated to pay interest or linkage differentials on an unclaimed dividend.

VOTING RIGHTS. Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders. Such voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future.

An ordinary resolution, such as a resolution for the declaration of dividends, requires approval by the holders of a majority of the voting rights represented at the meeting, in person, by proxy or by written ballot and voting on the matter. Under our articles of association, a special resolution, such as amending our memorandum of association or articles of association, approving any change in capitalization, winding-up, authorization of a class of shares with special rights, or other changes as specified in our articles of association, requires approval of a special majority, representing the holders of no less than 75% of the voting rights represented at the meeting in person, by proxy or by written ballot, and voting on the matter.

Pursuant to our articles of association, our directors are elected at our annual general meeting of shareholders for a term of three years by a vote of the holders of a majority of the voting power represented and voting at such meeting. and hold office until the third next annual general meeting of shareholders and until their successors have been elected. All the members of our Board of Directors (except the outside directors) may be reelected upon completion of their term of office. For information regarding the election of outside directors, see "Item 6C. Directors, Senior Management and Employees - Directors and Senior Management - Board Practices - Election of Directors."

RIGHTS TO SHARE IN THE COMPANY'S PROFITS. Our shareholders have the right to share in our profits distributed as a dividend and any other permitted distribution. See this Item 10B. "Additional Information - Memorandum and Articles of Association - Rights Attached to Shares - Dividend Rights."

RIGHTS TO SHARE IN SURPLUS IN THE EVENT OF LIQUIDATION. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to the nominal value of their holdings. This right may be affected by the grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

LIABILITY TO CAPITAL CALLS BY THE COMPANY. Under our memorandum of association and the Israeli Companies Law, the liability of our shareholders is limited to the par value of the shares held by them.

LIMITATIONS ON ANY EXISTING OR PROSPECTIVE MAJOR SHAREHOLDER. See Item 6A. "Directors and Senior Management - Approval of Related Party Transactions Under Israeli Law."

CHANGING RIGHTS ATTACHED TO SHARES

According to our articles of association, in order to change the rights attached to any class of shares, unless otherwise provided by the terms of the class, such change must be adopted by a general meeting of the shareholders and by a separate general meeting of the holders of the affected class with a majority of 75% of the voting power participating in such meeting.

ANNUAL AND SPECIAL GENERAL MEETINGS

The board of directors must convene an annual meeting of shareholders at least once every calendar year, within fifteen months of the last annual meeting. Depending on the matter to be voted upon, notice of at least 21 days or 35 days prior to the date of the meeting is required. Our board of directors may, in its discretion, convene additional meetings as "special general meetings." In addition, the board must convene a special general meeting upon the demand of two of the directors, 25% of the nominated directors, one or more shareholders having at least 5% of the outstanding share capital and at least 1% of the voting power in the company, or one or more shareholders having at least 5% of the voting power in the company.

The quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person or represented by proxy who hold or represent, in the aggregate, at least one third of the voting rights of the issued share capital. A meeting adjourned for lack of a quorum generally is adjourned to the same day in the following week at the same time and place or any time and place as the directors designate in a notice to the shareholders. At the reconvened meeting, the required quorum consists of any two members present in person or by proxy.

LIMITATIONS ON THE RIGHTS TO OWN SECURITIES IN OUR COMPANY

Neither our memorandum of association or our articles of association nor the laws of the State of Israel restrict in any way the ownership or voting of shares by non-residents, except with respect to subjects of countries which are in a state of war with Israel.

PROVISIONS RESTRICTING CHANGE IN CONTROL OF OUR COMPANY

The Israeli Companies Law requires that mergers between Israeli companies be approved by the board of directors and general meeting of shareholders of both parties to the transaction. The approval of the board of directors of both companies is subject to such board's confirmation that there is no reasonable doubt that after the merger the surviving company will be able to fulfill its obligations towards its creditors. Each company must notify its creditors about the contemplated merger. Generally, under the Israeli Companies Law, our articles of association are deemed to include a requirement that such merger be approved by a special resolution of the shareholders, as explained above. The approval of the merger by the general meetings of shareholders of the companies is also subject to additional approval requirements as specified in the Israeli Companies Law and regulations promulgated thereunder. See also "Item 6A. Directors, Senior Management and Employees - Directors and Senior Management - Approval of Related Party Transactions Under Israeli Law."

DISCLOSURE OF SHAREHOLDERS OWNERSHIP

The Israeli Securities Law and regulations promulgated thereunder do not require a company whose shares are publicly traded solely in a stock exchange outside of Israel, as in the case of our company, to disclose its share ownership.

CHANGES IN OUR CAPITAL

Changes in our capital are subject to the approval of the shareholders at a general meeting by a special majority of 75% of the votes of shareholders participating and voting in the general meeting.

C. MATERIAL CONTRACTS

None.

D. EXCHANGE CONTROLS

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares. In May 1998, a new "general permit" was issued under the Israeli Currency Control Law, 1978, which removed most of the restrictions that previously existed under such law, and enabled Israeli citizens to freely invest outside of Israel and freely convert Israeli currency into non-Israeli currencies.

Non-residents of Israel who purchase our ordinary shares will be able to convert dividends, if any, thereon, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares to an Israeli resident, into freely repatriable dollars, at the exchange rate prevailing at the time of conversion, provided that the Israeli income tax has been withheld (or paid) with respect to such amounts or an exemption has been obtained.

E. TAXATION

The following is a discussion of Israeli and United States tax consequences material to us and our shareholders. To the extent that the discussion is based on new tax legislation which has not been subject to judicial or administrative interpretation, the views expressed in the discussion might not be accepted by the tax authorities in question. The discussion is not intended, and should not be construed, as legal or professional tax advice and does not exhaust all possible tax considerations.

Holders of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

ISRAELI TAX CONSIDERATIONS

The following is a summary of the current tax structure applicable to companies in Israel, with special reference to its effect on us. The following also contains a discussion of the material Israeli tax consequences to purchasers of our ordinary shares and Israeli government programs benefiting us. This summary does not discuss all the aspects of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law.

GENERAL CORPORATE TAX RATE

Israeli companies are subject to income tax on their worldwide income regardless of the territorial source of such income. The applicable rate for 2006 was 31%. The rate was reduced to 29% in 2007, and will be further reduced to 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

LAW FOR THE ENCOURAGEMENT OF INDUSTRY (TAXES), 1969

Under the Encouragement of Industry (Taxes) Law 5729-1969, or the Industry Encouragement Law, Industrial Companies are entitled to certain corporate tax benefits, including, among others:

- Deduction, under certain conditions, of purchases of know-how and patents over an eight-year period for tax purposes;

- Right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli industrial companies;

- Accelerated depreciation rates on equipment and buildings; and

- Deductions over a three-year period of expenses involved with the issuance and listing of shares on the Tel Aviv stock exchange or, following January 1, 2003, on a recognized stock market outside of Israel.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. Under the Industry Encouragement Law, an "Industrial Company" is defined as a company resident in Israel, at least 90% of the income of which, in any tax year, determined in Israeli currency, exclusive of income from government loans, capital gains, interest and dividends, is derived from an "Industrial Enterprise" owned by it. An "Industrial Enterprise" is defined as an enterprise owned by an Industrial Company, whose major activity in a given tax year is industrial production activity.

We believe that we currently qualify as an Industrial Company within the definition of the Industry Encouragement Law. No assurance can be given that we will continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

LAW FOR THE ENCOURAGEMENT OF INDUSTRIAL RESEARCH AND DEVELOPMENT, 5744-1984

The Government of Israel encourages research and development projects through the Office of Chief Scientist of the Israeli Ministry of Industry, Trade and Labor, or the Office of the Chief Scientist, pursuant to the Law for the Encouragement of Industrial Research and Development, 5744-1984, and the regulations promulgated thereunder, commonly referred to as the Research Law. Grants received under such programs are repaid through a mandatory royalty based on revenues from products incorporating know-how developed with the grants. This government support is conditioned upon the ability of the participant to comply with certain applicable requirements and conditions specified in the Office of the Chief Scientist's programs and with the provisions of the Research Law.

Under the Research Law, research and development programs which meet specified criteria and are approved by a research committee of the Office of the Chief Scientist are eligible for grants of up to 50% of certain of the project's approved expenditure, as determined by the research committee.

In exchange, the recipient of such grants is required to pay the Office of the Chief Scientist royalties from the revenues derived from products incorporating technology developed within the framework of the approved research and development program or derived from such program (including ancillary services in connection with such program), usually up to 100% of the U.S. dollar-linked value of the total grants received in respect of such program, plus LIBOR interest.

The terms of the Israeli Government participation generally requires that the products developed with such grants be manufactured in Israel. However, under regulations promulgated under the Research Law, upon the approval of the Chief Scientist, some of the manufacturing volume may be performed outside Israel, provided that the grant recipient pays royalties at an increased rate. The Research Law also allows for the approval of grants in cases in which the applicant declares that part or all of the manufacturing will be performed outside of Israel or by foreign residents and the research committee is convinced that this is essential for the execution of the program. The Research Law also provides that know-how developed under an approved research and development program may not be transferred to third parties in Israel without the prior approval of the research committee. The Research Law further provides that the know-how developed under an approved research and development program may not be transferred to any third parties outside Israel. No approval is required for the sale or export of any products resulting from such research and development.

However, in June 2005, an amendment to the Research Law became effective, which amendment was intended to make the Research Law more compatible with the global business environment by, among other things, relaxing restrictions on the transfer of manufacturing rights outside Israel and on the transfer of Office of the Chief Scientist-funded know-how outside of Israel. The amendment permits the Office of the Chief Scientist, among other things, to approve the transfer of manufacturing rights outside Israel in exchange for an import of different manufacturing into Israel as a substitute, in lieu of demanding the recipient to pay increased royalties as described above. The amendment further permits, under certain circumstances and subject to the Office of the Chief Scientist's prior approval, the transfer outside Israel of know-how that has been funded by Office of the Chief Scientist, generally in the following cases: (a) the grant recipient pays to the Office of the Chief Scientist a portion of the consideration paid for such funded know-how (according to certain formulas), (b) the grant recipient receives know-how from a third party in exchange for its funded know-how, or (c) such transfer of funded know-how arises in connection with certain types of cooperation in research and development activities.

The Research Law imposes reporting requirements with respect to certain changes in the ownership of a grant recipient. The law requires the grant recipient and its controlling shareholders and interested parties to notify the Office of the Chief Scientist of any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a foreign resident becoming an interested party directly in the recipient and requires the new interested party to undertake to the Office of the Chief Scientist to comply with the Research Law. In addition, the rules of the Office of the Chief Scientist may require prior approval of the Office of the Chief

Scientist or additional information or representations in respect of certain of such events. For this purpose, "control" is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A person is presumed to have control if such person holds 50% or more of the means of control of a company. "Means of control" refers to voting rights or the right to appoint directors or the chief executive officer. An "interested party" of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any foreign resident who acquires 5% or more of our ordinary shares will be required to notify the Office of the Chief Scientist that it has become an interested party and to sign an undertaking to comply with the Research Law. Additionally, procedures regulated under the Research Law require the grant recipient to obtain the approval of the Office of the Chief Scientist prior to a change in the holdings of the recipient or change in the holdings of the means of control of the recipient if the recipient's shares are being issued to a foreign person or entity and require the new foreign party to undertake to the Office of the Chief Scientist to comply with the Research Law.

The funds available for grants from the Office of the Chief Scientist were reduced in 1998, however the Israeli authorities have indicated in the past that the government may increase grants from the Office of the Chief Scientist in the future.

In order to meet certain conditions in connection with the grants and programs of the Office of the Chief Scientist, we have made some representations to the Israeli government about our future plans for our Israeli operations. From time to time the extent of our Israeli operations has differed and may in the future differ, from our representations. If, after receiving grants under certain of such programs, we fail to meet certain conditions to those benefits or if there is any material deviation from the representations made by us to the Israeli government, we could be required to refund to the State of Israel tax or other benefits previously received (including interest and consumer price index linkage difference) and would likely be denied receipt of such grants or benefits, and participation of such programs, thereafter.

TAXATION UNDER INFLATIONARY CONDITIONS

The Income Tax Law (Inflationary Adjustments), 5745-1985, generally referred to as the Inflationary Adjustments Law, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is highly complex. Its features, which are material to us, can be summarized as follows:

o There is a special tax adjustment for the preservation of equity whereby some corporate assets are classified broadly into fixed assets and non-fixed assets. Where a company's equity, as defined in such law, exceeds the depreciated cost of fixed assets, a deduction from taxable income that takes into account the effect of the applicable annual rate of inflation on such excess is allowed up to a ceiling of 70% of taxable income in any single tax year, with the unused portion permitted to be carried forward on a linked basis. If the depreciated cost of fixed assets exceeds a company's equity, then such excess multiplied by the applicable annual rate of inflation is added to taxable income.

- Subject to specific limitations, depreciation deductions on fixed assets and losses carried forward are adjusted for inflation based on the increase in the consumer price index.

CAPITAL GAINS TAX ON SALES OF OUR ORDINARY SHARES

Under the Income Tax Ordinance [New Version], 5721-1961, commonly referred to as the Tax Ordinance, the general rule is that Israeli resident individuals are subject to a 20% tax rate on the real capital gains derived on or after January 1, 2003. Substantial individual shareholders (who are defined as shareholders of 10% or more of the shares of the company on the date of the sale of the shares or any date during the 12 months before the sale of the shares) are subject to a 25% tax rate on the real capital gains derived on or after January 1, 2003 from the sale of shares. Notwithstanding, capital gains of an Israeli resident individual from the sale of non-index linked debentures, commercial securities, State loans and/or loans, is subject to a 15% tax rate on the real capital gains derived on or after January 1, 2003 from the sale of such securities, while substantial individual holders of such non-index linked securities are subject to a 20% tax rate on the real capital gains derived on or after January 1, 2003 from the sale of such securities.

For the tax years 2006-2009, Israeli resident companies who were not subject to the provisions of Article 6 of the Inflationary Adjustments Law (which deals with the purchase and sale of securities publicly traded on a recognized stock exchange during periods of inflation) prior to August 10, 2005, are subject to 25% tax rate on real capital gains derived on or after January 1, 2003 from the sale of securities publicly traded on a recognized stock exchange. Notwithstanding the above, Israeli resident companies which were subject to the provisions of Article 6 of the Inflationary Adjustments Law prior to August 10, 2005, are subject to the regular corporate tax rate on real capital gains derived from the sale of securities publicly traded on a recognized stock exchange.

Under income tax regulations foreign residents, who sell shares of an Israeli company publicly traded on a recognized stock exchange outside of Israel, will be exempt from tax subject to the satisfaction of all following conditions:

- The capital gain is not attributable to a permanent establishment in Israel

- The shares were purchased after the first initial public offering on the recognized stock exchange outside of Israel

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Pursuant to the convention between the governments of the United States of America and Israel with respect to taxes on income, as amended, referred to as the Treaty, the sale, exchange or disposition of ordinary shares by a person who qualifies as a resident of the United States within the meaning of the Treaty and who is entitled to claim the benefits afforded to such person by the Treaty generally will not be subject to the Israeli capital gains tax unless such U.S. resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to particular conditions. A sale, exchange or disposition of ordinary shares by such a U.S. resident who holds, directly or indirectly, shares representing 10% or more of our voting power at any time during such preceding 12-month period would be subject to such Israeli tax, to the extent applicable; however, under such U.S. resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations under U.S. laws applicable to foreign tax credits. The Treaty does not relate to U.S. state or local taxes.

TAXATION OF FOREIGN RESIDENT HOLDERS OF SHARES

Foreign residents are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. On distributions of dividends after January 1 2006 other than bonus shares or stock dividends, income tax at the rate of 20% will be withheld on dividends distributed to Israeli individual shareholders or to a foreign resident.

The foregoing tax rates are withheld at source, unless a different rate is provided by a treaty between Israel and the shareholder's country of residence. (For instance under the provisions of the treaty between Israel and the United States 12.5% tax rate is imposed on dividends not generated by an approved enterprise if the foreign resident is a U.S. corporation that holds 10% of a company's voting power, and 15% on dividends generated by an approved enterprise. In addition under the Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a U.S. resident within the meaning of the Treaty will be 25%).

FOREIGN EXCHANGE REGULATIONS

Dividends (if any) paid to the holders of our ordinary shares, and any amounts payable with respect to our ordinary shares upon dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of the ordinary shares to an Israeli resident, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely reparable U.S. dollars at the rate of exchange prevailing at the time of conversion, however, Israeli income tax is required to have been paid or withheld on these amounts.

CONTROLLED FOREIGN CORPORATION

In general, and subject to the provisions of all relevant legislation, an Israeli resident who holds, directly of indirectly, 10% or more of the rights in a foreign corporation whose shares are not publicly traded, in which more than 50% of the rights are held directly or indirectly by Israeli residents, and a majority of whose income in a tax year is considered passive income (generally referred to as a Controlled Foreign Corporation, or CFC), is liable for tax on the portion of his income attributed to holdings in such corporation, as if such income was distributed to him as a dividend.

SHARE ALLOCATIONS TO EMPLOYEES

In general, the section of the Tax Ordinance that deals with taxation of share allocations to employees and/or officers (excluding controlling members) provides that a company may choose one of three courses of taxation which course must be approved by the assessing officer: (i) work income course for shares held 12 months in trust; (ii) capital gains course for shares held 24 months in trust; and (iii) allocation not through a trustee. Each of these courses has different tax consequences.

As of January 1, 2006, the periods mentioned in the first two courses commence as of the date of grant and not as of the end of the tax year in which the shares were granted.

STAMP DUTY

Documents signed after January 1, 2006 are not subject to stamp tax.

UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

The following is a summary of certain material U.S. federal income tax consequences that apply to U.S. Holders who hold ordinary shares as capital assets. This summary is based on the United States Internal Revenue Code of 1986, as amended (the "Code"), Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. This summary does not address all tax considerations that may be relevant with respect to an investment in ordinary shares. This summary does not discuss all the tax consequences that may be relevant to a U.S. Holder in light of such holder's particular circumstances or to U.S. Holders subject to special rules, including persons that are non-U.S. Holders, broker-dealers, financial institutions, certain insurance companies, investors liable for alternative minimum tax, tax-exempt organizations, regulated investment companies, foreign resident aliens of the U.S. or taxpayers whose functional currency is not the U.S. dollar, persons who hold the ordinary shares through partnerships or other pass-through entities, persons who acquired their ordinary shares through the exercise or cancellation of employee stock options or otherwise as compensation for services, investors that actually or constructively own 10 percent or more of our voting shares, and investors holding ordinary shares as part of a straddle or appreciated financial position or as part of a hedging or conversion transaction.

If a partnership or an entity treated as a partnership for U.S. federal income tax purposes owns ordinary shares, the U.S. federal income tax treatment of a partner in such a partnership will generally depend upon the status of the partner and the activities of the partnership. A partnership that owns ordinary shares and the partners in such partnership should consult their tax advisors about the U.S. federal income tax consequences of holding and disposing of ordinary shares.

This summary does not address the effect of any U.S. federal taxation other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation.

You are urged to consult your tax advisors regarding the foreign and United States federal, state and local tax considerations of an investment in ordinary shares.

For purposes of this summary, the term "U.S. Holder" means an individual who is a citizen or, for U.S. federal income tax purposes, a resident of the United States, a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States or any political subdivision thereof, an estate whose income is subject to U.S. federal income tax regardless of its source, or a trust that (a) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons or (b) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

TAXATION OF DIVIDENDS

Subject to the discussion below under "Passive Foreign Investment Companies," the gross amount of any distributions received with respect to ordinary shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. federal income tax purposes to the extent of our current and accumulated earnings and profits, as determined under U.S. federal income tax principles. You will be required to include this amount of dividends in gross income as ordinary income. Distributions in excess of our current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of your tax basis in the ordinary shares and any amount in excess of your tax basis will be treated as gain from the sale of ordinary shares. See "-Disposition of Ordinary Shares" below for the discussion on the taxation of capital gains. Dividends will not qualify for the dividends-received deduction generally available to corporations under Section 243 of the Code.

Dividends that we pay in NIS, including the amount of any Israeli taxes withheld therefrom, will be included in your income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day such dividends are received. A U.S. Holder who receives payment in NIS and converts NIS into U.S. dollars at an exchange rate other than the rate in effect on such day may have a foreign currency exchange gain or loss that would be treated as ordinary income or loss. U.S. Holders should consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of NIS.

Subject to complex limitations, any Israeli withholding tax imposed on such dividends will be a foreign income tax eligible for credit against a U.S. Holder's U.S. federal income tax liability (or, alternatively, for deduction against income in determining such tax liability). The limitations set out in the Code include computational rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income taxes otherwise payable with respect to each such class of income. Dividends generally will be treated as foreign-source passive category income or, in the case of certain U.S. Holders, general category income for United States foreign tax credit purposes. Further, there are special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to a reduced tax, see discussion below. A U.S. Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on the ordinary shares to the extent such U.S. Holder has not held the ordinary shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date or to the extent such U.S. Holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a U.S. Holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the 16-day holding period required by the statute. The rules relating to the determination of the foreign tax credit are complex, and you should consult with your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to certain limitations, "qualified dividend income" received by a noncorporate U.S. Holder in tax years beginning on or before December 31, 2010 will be subject to tax at a reduced maximum tax rate of 15 percent. Distributions taxable as dividends paid on the ordinary shares should qualify for the 15 percent rate provided that either: (i) we are entitled to benefits under the income tax treaty between the United States and Israel (the "Treaty") or (ii) the ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that the ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that the ordinary shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied. With respect to the ordinary shares, the U.S. Holder must have held such shares for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date. The rate reduction also does not apply to dividends received from passive foreign investment companies, see discussion below, or in respect of certain hedged positions or in certain other situations. The legislation enacting the reduced tax rate contains special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to the reduced tax rate. U.S. Holders of ordinary shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.

DISPOSITION OF ORDINARY SHARES

If you sell or otherwise dispose of ordinary shares, you will recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and your adjusted tax basis in the ordinary shares. Subject to the discussion below under the heading "Passive Foreign Investment Companies," such gain or loss generally will be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses, will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

In the case of a cash basis U.S. Holder who receives NIS in connection with the sale or disposition of ordinary shares, the amount realized will be based on the U.S. dollar value of the NIS received with respect to the ordinary shares as determined on the settlement date of such exchange. A U.S. Holder who receives payment in NIS and converts NIS into United States dollars at a conversion rate other than the rate in effect on the settlement date may have a foreign currency exchange gain or loss that would be treated as ordinary income or loss.

An accrual basis U.S. Holder may elect the same treatment required of cash basis taxpayers with respect to a sale or disposition of ordinary shares, provided that the election is applied consistently from year to year. Such election may not be changed without the consent of the Internal Revenue Service (the "IRS"). In the event that an accrual basis U.S. Holder does not elect to be treated as a cash basis taxpayer (pursuant to the Treasury regulations applicable to foreign currency transactions), such U.S. Holder may have a foreign currency gain or loss for U.S. federal income tax purposes because of differences between the U.S. dollar value of the currency received prevailing on the trade date and the settlement date. Any such currency gain or loss would be treated as ordinary income or loss and would be in addition to gain or loss, if any, recognized by such U.S. Holder on the sale or disposition of such ordinary shares.

PASSIVE FOREIGN INVESTMENT COMPANIES

For U.S. federal income tax purposes, we will be considered a passive foreign investment company ("PFIC") for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, passive income includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets which produce passive income. If we were determined to be a PFIC for U.S. federal income tax purposes, highly complex rules would apply to U.S. Holders owning ordinary shares. Accordingly, you are urged to consult your tax advisors regarding the application of such rules.

Based on our current and projected income, assets and activities, we believe that we are not currently a PFIC nor do we expect to become a PFIC in the foreseeable future. However, because the determination of whether we are a PFIC is based upon the composition of our income and assets from time to time, there can be no assurances that we will not become a PFIC for any future taxable year.

If we are treated as a PFIC for any taxable year, dividends would not qualify for the reduced maximum tax rate, discussed above, and, unless you elect either to treat your investment in ordinary shares as an investment in a "qualified electing fund" (a "QEF election") or to "mark-to-market" your ordinary shares, as described below:

- you would be required to allocate income recognized upon receiving certain dividends or gain recognized upon the disposition of ordinary shares ratably over the holding period for such ordinary shares,

- the amount allocated to each year during which we are considered a PFIC and subsequent years, other than the year of the dividend payment or disposition, would be subject to tax at the highest individual or corporate tax rate, as the case may be, in effect for that year and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year,

- the amount allocated to the current taxable year and any taxable year before we became a PFIC would be taxable as ordinary income in the current year, and

- you would be required to make an annual return on IRS Form 8621 regarding distributions received with respect to ordinary shares and any gain realized on your ordinary shares.

If you make either a timely QEF election or a timely mark-to-market election in respect of your ordinary shares, you would not be subject to the rules described above. If you make a timely QEF election, you would be required to include in your income for each taxable year your pro rata share of our ordinary earnings as ordinary income and your pro rata share of our net capital gain as long-term capital gain, whether or not such amounts are actually distributed to you. You would not be eligible to make a QEF election unless we comply with certain applicable information reporting requirements.

Alternatively, if the ordinary shares are considered "marketable stock" and if you elect to "mark-to-market" your ordinary shares, you will generally include in income any excess of the fair market value of the ordinary shares at the close of each tax year over your adjusted basis in the ordinary shares. If the fair market value of the ordinary shares had depreciated below your adjusted basis at the close of the tax year, you may generally deduct the excess of the adjusted basis of the ordinary shares over its fair market value at that time. However, such deductions generally would be limited to the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years. Income recognized and deductions allowed under the mark-to-market provisions, as well as any gain or loss on the disposition of ordinary shares with respect to which the mark-to-market election is made, is treated as ordinary income or loss (except that loss on a disposition of ordinary shares is treated as capital loss to the extent the loss exceeds the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years). Gain or loss from the disposition of ordinary shares (as to which a mark-to-market election was made) in a year in which we are no longer a PFIC, will be capital gain or loss.

BACKUP WITHHOLDING AND INFORMATION REPORTING

Payments in respect of ordinary shares may be subject to information reporting to the U.S. Internal Revenue Service and to U.S. backup withholding tax at a rate equal to the fourth lowest income tax rate applicable to individuals (which, under current law, is 28%). Backup withholding will not apply, however, if you (i) are a corporation or come within certain exempt categories, and demonstrate the fact when so required, or (ii) furnish a correct taxpayer identification number and make any other required certification.

Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules may be credited against a U.S. Holder's U.S. tax liability, and a U.S. Holder may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS.

Any U.S. Holder who holds 10% or more in vote or value of our ordinary shares will be subject to certain additional United States information reporting requirements.

U.S. GIFT AND ESTATE TAX

An individual U.S. Holder of ordinary shares will be subject to U.S. gift and estate taxes with respect to ordinary shares in the same manner and to the same extent as with respect to other types of personal property.

F. DIVIDEND AND PAYING AGENTS

Not applicable.

G. STATEMENT BY EXPERTS

Not applicable.

H. DOCUMENTS ON DISPLAY

We are subject to the reporting requirements of the United States Securities Exchange Act of 1934, as amended, as applicable to "foreign private issuers" as defined in Rule 3b-4 under the Exchange Act, and in accordance therewith, we file annual and interim reports and other information with the Securities and Exchange Commission.

As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, transactions in our equity securities by our officers and directors are exempt from reporting and the "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements as frequently or as promptly as United States companies whose securities are registered under the

Exchange Act. However, we distribute annually to our shareholders an annual report containing financial statements that have been examined and reported on, with an opinion expressed by, an independent public accounting firm, and we intend to file reports with the Securities and Exchange Commission on Form 6-K containing unaudited financial information for the first three quarters of each fiscal year.

This annual report and the exhibits thereto and any other document we file pursuant to the Exchange Act may be inspected without charge and copied at prescribed rates at the following Securities and Exchange Commission public reference rooms: 100 F Street, N.E., Room 1580, Washington, D.C. 20549; and on the Securities and Exchange Commission Internet site (http://www.sec.gov) and on our website www.rada.com. You may obtain information on the operation of the Securities and Exchange Commission's public reference room in Washington, D.C. by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Exchange Act file number for our Securities and Exchange Commission filings is 0-30198.

The documents concerning our company which are referred to in this annual report may also be inspected at our offices located at 7 Giborei Israel Street, Netanya 42504, Israel.

I. SUBSIDIARY INFORMATION

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS

INTEREST RATE RISK

We currently do not invest in, or otherwise hold, for trading or other purposes, any financial instruments subject to market risk. We pay interest on our credit facilities, convertible notes and short-term loans based on Libor, for dollar-denominated loans, and Israeli prime or adjustment differences to the Israeli consumer price index, for some of our NIS-denominated loans. As a result, changes in the general level of interest rates directly affect the amount of interest payable by us under these facilities. However, we expect our exposure to market risk from changes in interest rates to be minimal and not material. Therefore, no quantitative tabular disclosures are required.

A devaluation of the NIS in relation to the U.S. dollar has the effect of reducing the U.S. dollar amount of any of our expenses or liabilities which are payable in NIS (unless such expenses or payables are linked to the U.S. dollar). As of December 31, 2006, we had liabilities payable in NIS which are not linked to the U.S. dollar in the amount of $2.8 million and cash and receivables in the amount of $2.5 million denominated in NIS. Accordingly, an increase of 1% of the NIS against the dollar would increase our financing expenses by approximately $1,000. A devaluation of 1% of the NIS against the dollar would decrease our financing expenses by the same amount. Neither a ten percent increase nor decrease in current exchange rates would have a material affect on our consolidated financial statements. However, the amount of liabilities payable and/or cash and receivables in NIS is likely to change from time to time.

Because exchange rates between the NIS and the U.S. dollar fluctuate continuously (albeit with a historically declining trend in the value of the NIS), exchange rate fluctuations and especially larger periodic devaluations will have an impact on our profitability and period-to-period comparisons of our results. The effects of foreign currency re-measurements are reported in our consolidated financial statements in continuing operations.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

None.

ITEM 15. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our chief executive officer and chief financial officer to allow timely decisions regarding required disclosure. Our management, including our chief executive officer and chief financial officer, conducted an evaluation of our disclosure controls and procedures, as defined under Exchange Act Rule 13a-15(e), as of the end of the period covered by this Annual Report on Form 20-F. Based upon that evaluation, our chief executive officer and chief financial officer have concluded that, as of such date, our disclosure controls and procedures were effective.

ITEM 15T. CONTROLS AND PROCEDURES

Not applicable.

ITEM 16. RESERVED.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that that Mr. Eli Akavia, one of our outside directors, qualifies as an independent director as this term is defined by the rules of the Securities and Exchange Committee and NASDAQ, and meets the definition of an audit committee financial expert, as defined by rules of the Securities and Exchange Commission. For a brief listing of Mr. Akavia's relevant experience, see Item 6.A. "Directors, Senior Management and Employees - Directors and Senior Management."

ITEM 16B. CODE OF ETHICS

We have adopted a code of ethics that applies to our chief executive officer and all senior financial officers of our company, including the chief financial officer, chief accounting officer or controller, or persons performing similar functions. The code of ethics is publicly available on our website at www.rada.com. Written copies are available upon request. If we make any substantive amendment to the code of ethics or grant any waivers, including any implicit waiver, from a provision of the codes of ethics, we will disclose the nature of such amendment or waiver on our website.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

FEES PAID TO INDEPENDENT PUBLIC ACCOUNTANTS

The following table sets forth, for each of the years indicated, the fees paid to our principal independent registered public accounting firm. All of such fees were pre-approved by our Audit Committee.

	Year Ended December 31	
Services Rendered	2005	2006
Audit (1)	$ 77,500	$ 74,000
Audit-related (2) ..	$ 7,500	-
Total	$ 85,000	$ 74,000

(1) Audit fees consist of services that would normally be provided in connection with statutory and regulatory filings or engagements, including services that generally only the independent registered public accounting firm can reasonably provide, such as services preformed in connection with documents filed with the SEC.

(2) Audit related fees consist of fees for assurance and related services by the independent registered public accounting firm that are reasonably related to the performance of the audit or review of the registrant financial statements.

PRE-APPROVAL POLICIES AND PROCEDURES

Our Audit Committee has adopted a policy and procedures for the pre-approval of audit and non-audit services rendered by our independent registered accounting firm, Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global. Pre-approval of an audit or non-audit service may be given as a general pre-approval, as part of the audit committee's approval of the scope of the engagement of our independent auditor, or on an individual basis. The policy prohibits retention of the independent public accountants to perform the prohibited non-audit functions defined in Section 201 of the Sarbanes-Oxley Act or the rules of the Securities and Exchange Committee, and also requires the Audit Committee to consider whether proposed services are compatible with the independence of the public accountants.

ITEM 16D. EXEMPTIONS FROM THE LISTING REQUIREMENTS AND STANDARDS FOR AUDIT COMMITTEE

Not applicable.

ITEM 16E. PURCHASE OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

ISSUER PURCHASE OF EQUITY SECURITIES

Neither we nor any affiliated purchaser has purchased any of our securities during 2006.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

CONSOLIDATED FINANCIAL STATEMENTS

ITEM 19. EXHIBITS

INDEX TO EXHIBITS

EXHIBIT	DESCRIPTION
1.1	Memorandum of Association of the Registrant*
1.2	Articles of Association of the Registrant*
2.1	Specimen of Share Certificate*
4.3	1999 Employee Stock Option Plan, as amended*
4.4	2003 Employee Stock Option Plan, as amended**
4.8	Memorandum of Agreement dated June 23 2003 between the Registrant and Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M.**
8	List of Subsidiaries of the Registrant
12.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
12.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
13.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
23.1	Consent of Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global, Independent Registered Public Accounting Firm (Israel) with respect to our Registration Statements on Form F-3 and S-8

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* Filed as an exhibit to our Annual Report on Form 20-F for the year ended December 31, 2000 and incorporated herein by reference.

** Filed as an exhibit to our Annual Report on Form 20-F for the year ended December 31, 2002 and incorporated herein by reference.

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2006

U.S. DOLLARS IN THOUSANDS

INDEX

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE SHAREHOLDERS OF

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

We have audited the accompanying consolidated balance sheets of Rada Electronic Industries Ltd. ("the Company") and its subsidiary as of December 31, 2006 and 2005 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the consolidated financial position of the Company and its subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2p to the consolidated financial statements, in 2006 the Company adopted Statement Financial Accounting Standards Board No. 123 (revised 2004), "Share-Based Payment".

/S/Kost Forer Gabbay and Kasierer
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Tel-Aviv, Israel
March 29, 2007

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

U.S. DOLLARS IN THOUSANDS

	NOTE	DECEMBER 31, 2006	2005
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents		$ 990	$ 350
Restricted cash		704	1,017
Trade receivables (net of allowance for doubtful accounts of $ 34 and $ 6 at December 31, 2006 and 2005, respectively)		4,296	4,920
Other accounts receivable and prepaid expenses		200	156
Costs and estimated earnings in excess of billings on uncompleted contracts	3	668	1,396
Inventories	4	2,468	1,942
TOTAL current assets		9,326	9,781
LONG-TERM RECEIVABLES AND DEPOSITS:			
Long-term receivables	5	983	983
Leasing deposits		78	72
Severance pay fund		1,624	1,614

TOTAL long-term receivables and deposits		2,685	2,669
PROPERTY, PLANT AND EQUIPMENT, NET	6	3,359	3,931
OTHER ASSETS:			
Intangible assets, net	7	1,906	2,469
Goodwill	7	166	-
Deferred charges, net		13	40
TOTAL other assets		2,085	2,509
TOTAL assets		$17,455	$18,890

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

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

		DECEMBER 31,	
	NOTE	2006	2005
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Short-term bank credit	8a	$ 238	$ 1
Current maturities of long-term loans	8b	321	7
Convertible note	11	2,858	
Trade payables		1,611	1,6
Other accounts payable and accrued expenses	9	3,419	3,2
Deferred revenues		84	
Billings in excess of costs and estimated earnings on uncompleted contracts	3	285	3
TOTAL current liabilities		8,816	6,2
LONG-TERM LIABILITIES:			
Long-term loans	8b	142	
Convertible note	11	-	2,5
Accrued severance pay		2,026	2,0
TOTAL long-term liabilities		2,168	4,5

COMMITMENTS AND CONTINGENT LIABILITIES	10		
MINORITY INTERESTS		397	3
SHAREHOLDERS' EQUITY:	11		
Share capital -			
Ordinary shares of NIS 0.015 par value - Authorized: 16,333,333 and 15,833,333 shares at December 31, 2006 and 2005, respectively; Issued and outstanding: 8,728,509 and 8,714,676 shares at December 31, 2006 and 2005, respectively		116	1
Additional paid-in capital		67,239	66,9
Accumulated deficit		(61,281)	(59,2
TOTAL shareholders' equity		6,074	7,7
TOTAL liabilities and shareholders' equity		$ 17,455	$ 18,8

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

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RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA

		YEAR ENDED DECEMBER 31,	
	NOTE	2006	2005
Revenues:	15		
Products		$ 10,984	$ 11,303
Services		2,053	2,118
		13,037	13,421
Cost of revenues:			
Products		9,517	10,601
Services		1,482	1,481
		10,999	12,082
Gross profit		2,038	1,339

Operating costs and expenses:			
Research and development		181	-
Marketing and selling		1,316	1,155
General and administrative		1,794	1,939
TOTAL operating costs and expenses		3,291	3,094
Operating income (loss)		(1,253)	(1,755)
Financial expenses, net	13	(775)	(624)
Other income, net		45	33
		(1,983)	(2,346)
Minority interests in losses (earnings) of subsidiary		(17)	17
Net income (loss)		$ (2,000)	$ (2,329)
Net earnings (loss) per share:	16		
Basic net earnings (loss) per share		$ (0.23)	$ (0.31)
Diluted net earnings (loss) per share		$ (0.23)	$ (0.31)

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

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE DATA

	NUMBER OF ORDINARY SHARES	SHARE CAPITAL	ADDITIONAL PAID-IN CAPITAL
Balance at January 1, 2004	6,170,238	$ 108	$ 60,544
Issuance of Ordinary shares and warrants, net *)	621,438	2	3,300
Beneficial conversion feature on convertible note	-	-	180
Exercise of options	24,445	***) -	50
Net income	-	-	-
Balance at December 31, 2004	6,816,121	110	64,074

Issuance of Ordinary shares and warrants, net *)	321,978	1	1,005
Exercise of warrants, net **)	1,563,688	5	1,794
Exercise of options	12,889	***) -	27
Net loss	-	-	-
Balance at December 31, 2005	8,714,676	116	66,900
Exercise of options	13,833	***) -	28
Share-based compensation for employees	-	-	221
Issuance expenses related to stamp tax provision	-	-	90
Net loss	-	-	-
Balance at December 31, 2006	8,728,509	116	67,239

*) Net of issuance expenses of approximately $ 85 and $ 95 for the years ended December 31, 2005 and 2004, respectively.

**) Net of issuance expenses of approximately $ 148.

***) Represents an amount lower than $ 1.

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

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

	YEAR ENDED DECEMBE	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$(2,000)	$(2,329)
Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,398	1,347
Amortization expense on convertible note	298	214
Minority interests in earnings (losses) of subsidiary	17	(17)
Share-based compensation for employees	221	-
Accrued interest and translation differences on long-term receivables	-	-
Capital loss on property, plant and equipment	-	-
Severance pay, net	7	(30)
Decrease (increase) in trade receivables, net	624	(2,676)
Decrease (increase) in other accounts receivable and prepaid expenses	(44)	81
Decrease (increase) in costs and estimated earnings in excess of		

billings, net	622	(685)
Decrease (increase) in inventories	(526)	200
Increase (decrease) in trade payables	(60)	(219)
Increase (decrease) in other accounts payable and accrued expenses	126	(444)
Increase (decrease) in deferred revenues	34	(568)
Net cash provided by (used in) operating activities	717	(5,126)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid in conjunction with the acquisition of certain assets and liabilities of Vectop, net (a)	-	(351)
Deduction of long-term restricted cash	313	-
Investment in restricted cash	-	(15)
Purchase of property, plant and equipment	(236)	(411)
Increase (decrease) in leasing deposits	(6)	22
Loans repaid by employees	-	5
Net cash provided by (used in) investing activities	71	(750)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of Ordinary shares and warrants, net	-	1,006
Proceeds from issuance of convertible note, net	-	-
Proceeds from short-term loans	-	700
Proceeds from long-term loans	288	-
Proceeds from bridge loan	650	-
Repayment of bridge loan	(650)	-
Repayments of current maturities of long-term loans	(525)	(933)
Short-term bank credit, net	61	163
Exercise of warrants, net	-	1,799
Exercise of options	28	27
Net cash provided by (used in) financing activities	(148)	2,762
Increase (decrease) in cash and cash equivalents	640	(3,114)
Cash and cash equivalents at the beginning of the year	350	3,464
Cash and cash equivalents at the end of the year	$ 990	$ 350
NON-CASH TRANSACTIONS:		
Goodwill in respect of Vectop (royalties payable)	166	$ -
Issuance expenses related to stamp tax provision	90	$ -

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

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

	YEAR ENDED DECEMBER 31, 2005
(a) CASH PAID IN CONJUNCTION WITH THE ACQUISITION OF CERTAIN ASSETS AND LIABILITIES OF VECTOP, NET (SEE ALSO NOTE 1D):	
Working capital, net	$ 844
Equipment	(62)
Intangible assets	(1,263)
Deferred revenues	130
	$ (351)

	YEAR ENDED DECEMBER 31, 2006	2005	2004
(b) SUPPLEMENTAL DISCLOSURES OF CASH FLOW ACTIVITIES:			
Net cash paid during the year for:			
Income taxes	$ 14	$ 3	$ 3
Interest	$307	$396	$290

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

RADA ELECTRONIC INDUSTRIES LTD.AND ITS SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 1:- GENERAL

a. Rada Electronic Industries Ltd., an Israeli corporation ("the Company"), is engaged in the development, manufacture and sale of Automated Test Equipment ("ATE") products, avionics equipment and aviation data acquisition and debriefing systems.

b. As reflected in the consolidated financial statements, as of December 31, 2006, the Company has an accumulated deficit of $ 61,281. Based on continued financial support from the Company's shareholders, existing and anticipated orders in 2007, management believes that the anticipated cash flows from operations, will enable the Company to finance its operations at least through December 31, 2007.

c. The Company operates a test and repair shop using its ATE products in Beijing, China through its 80% owned Chinese subsidiary, Beijing Huari Aircraft Components Maintenance and Services Co. Ltd. ("CACS" or "subsidiary"). CACS was established with a third party, which owns the remaining 20% equity interest.

d. On February 13, 2005, the Company purchased certain assets and assumed certain liabilities related to the operations of Vectop Limited ("Vectop") in order to increase its customer base. Vectop is an Israeli company specializing in the design, development, marketing and sale of electro-optic equipment and debriefing systems. Vectop's assets also include know-how, patents and intellectual property to produce off-the-shelf products such as cameras and video recorders, which are currently operational onboard aircraft and tanks in Israel and other countries. The Company purchased Vectop's net assets for $ 381 in cash and additional future royalties based on revenues derived from Vectop projects five years from the date of the agreement up to $ 500. The net assets purchased are considered to be a business, in accordance with EITF 98-3, "Determining Whether a Non-monetary Transaction Involves Receipt of Productive Assets or Business". The acquisition was accounted for under the purchase method of accounting in accordance with FAS 141, "Business Combinations", and the results of Vectop operations have been included from the acquisition date (February 2005). The purchase price related to the acquisition of Vectop was allocated to the fair market value of tangible and intangible assets acquired and liabilities assumed at the date of acquisition, as detailed below.

Cash and cash equivalents	$ 30
Trade receivables	601
Other current assets	347
Equipment	62
Customer relationships (five-year useful life)	1,263
TOTAL assets acquired	2,303
Short-term bank credit and loans	933
Trade payables	810
Other accounts payable and accrued expenses	49
Deferred revenues	130
TOTAL liabilities assumed	1,922
Net assets acquired	$ 381

RADA ELECTRONIC INDUSTRIES LTD.AND ITS SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 1:- GENERAL (CONT.)

Customer relationships were determined by Company's management using the discounted cash flows approach and is being amortized on a straight-line basis over the expected useful life of five years (see also Note 7).

The following table presents unaudited pro forma results of operations and gives effect to the acquisition of Vectop as if the acquisition had been consummated at January 1, 2004. The unaudited pro forma results of operations are not necessarily indicative of what would have occurred had the acquisition been made as of the beginning of this period or the results that may occur in the future. Net income for the period presented includes amortization of intangible assets related to the acquisition of $ 253. The unaudited pro forma information is as follows:

	YEAR ENDED DECEMBER 31, 2004
	UNAUDITED
Revenues	$17,187
Net income from continuing operations	$ 910
Basic net income per share from continuing operations	$ 0.05
Diluted net income per share from continuing operations	$ 0.04
Weighted average number of Ordinary shares in computation of basic net earnings per share	6,458
Weighted average number of Ordinary shares in computation of diluted net earnings per share	7,895

e. As for major customers, see Note 15.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The significant accounting policies followed in the preparation of the financial statements, applied on a consistent basis, are as follows:

a. Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

b. Financial statements in U.S. dollars:

Most of the revenues of the Company and its subsidiary are generated in U.S. dollars ("dollar"). In addition, a substantial portion of the costs of the Company and its subsidiary is incurred in dollars. The Company's management believes that the dollar is the currency of the primary economic environment in which the Company and its subsidiary operate. Thus, their functional and reporting currency is the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with Statement of the Financial Accounting Standard Board No. 52, "Foreign Currency Translation" ("SFAS No. 52"). All transaction gains and losses of the remeasured monetary balance sheet items are reflected in the statement of operations as financial income or expenses, as appropriate, in the period in which the currency exchange rate changes. The representative exchange rate at December 31, 2006 was U.S. $ 1.00 = NIS 4.225, December 31, 2005 was U.S. $ 1.00 = NIS 4.603 and December 31, 2004 - NIS 4.308.

c. Basis of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiary. Inter-company transactions and balances have been eliminated upon consolidation.

d. Cash equivalents and restricted cash:

All highly liquid investments that are readily convertible to cash and are not restricted as to withdrawal or use and the period to maturity of which did not exceed three months at time of deposit, are considered cash equivalents.

Restricted cash is invested in a short-term bank deposit (less than three months), which is mainly used as security for the Company's guarantees to customers. The deposit is in U.S. dollars and bears interest at an average rate of 4.6%.

e. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs are provided to cover risks arising from slow-moving items, excess inventories and for market prices lower than cost.

Cost is determined as follows:

Raw materials and components- using the "first-in, first-out" cost method.

Work in progress and finished goods- represents the cost of manufacturing with the addition of allocable indirect manufacturing costs.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

Amounts related to long-term contracts as determined by the percentage of completion method of accounting are recorded as "Costs and estimated earnings in excess of billings."

f. Property, plant and equipment:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets. Annual rates of depreciation are as follows:

	%
Factory and other buildings	2.5 - 4
Machinery and equipment	10 - 15,33
Office furniture and equipment	6 - 15

Leasehold improvements are depreciated over the shorter of the estimated useful life or the lease period.

Assets in respect of which investment grants have been received, are presented at cost less the related grant amount. Depreciation is based on net cost.

g. Intangible assets:

Capitalized software costs are amortized by the greater of the amount computed using the: (i) ratio of current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the product. The Company assesses the recoverability of these intangible assets on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold.

At each balance sheet date, the unamortized capitalized costs of the software products are compared to the net realizable value of the product. If the unamortized capitalized costs of a computer software product exceed the net realizable value of the product, such excess is written off. The net realizable value is calculated as the estimated future gross revenues from the product reduced by the estimated future costs of completing and disposing of that product, including the costs of performing maintenance and customer support required to satisfy the Company's responsibility set forth at the time of the sale.

A customer relationships asset (intangible asset) has been recorded as a result of the acquisition of Vectop and is amortized using the straight-line basis over the expected useful life of five years.

As for impairment charges included in these financial statements, see Note 7.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

h. Goodwill

Goodwill represents excess of the costs over the net assets of businesses acquired. Under SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") goodwill acquired in a business combination should not be amortized. SFAS No. 142 requires goodwill to be tested for impairment at least annually or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. In 2006, the Company recorded goodwill in respect of additional consideration payable in connection with the acquisition of Vectop. The Company determines fair value of goodwill using market capitalization and is tested for impairment by comparing the fair market value with its carrying amount. As of December 31, 2006, no impairment losses have been identified.

i. Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2006, no impairment losses have been identified.

j. Research and development costs:

Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise

Marketed" ("SFAS No. 86"), requires capitalization of certain software development, costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon completion of a working model.

Research and development costs incurred in the process of developing product masters and the Company's Test System Programs Sets ("TPS") software library, integrated with the Company's test station, are charged to expenses as incurred.

Costs incurred by the Company between completion of the working model and the point at which the product is ready for general release, have been capitalized.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

k. Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes" ("SFAS 109"). This statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax based assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

l. Severance pay:

The Company's liability for severance pay is calculated pursuant to Israel's Severance Pay Law generally based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. The Company's liability for all of its Israeli employees is partly provided by monthly deposits for insurance policies and/or pension funds and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet. The deposited funds of the Company's employees include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements.

The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expense recorded in the statement of operations is net of interest and other income accumulated in the deposits. Severance expense for the years ended December 31, 2006, 2005 and 2004 amounted to $ 43, $ 57 and $ 76, respectively.

m. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating fair value and disclosures for financial instruments:

The carrying amount of cash and cash equivalents, restricted cash, trade receivables, short-term bank credit and trade payables approximate their fair value due to the short-term maturity of these instruments.

The fair value of the convertible notes and long-term loans are estimated by discounting the future cash flows using current interest rates for loans of similar terms and maturities. The carrying amount of the convertible notes and long-term loans approximate their fair value.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

n. Concentrations of credit risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, restricted cash, trade receivables and long-term receivables.

The Company's cash and cash equivalents and restricted cash are mainly held in U.S. dollars with major banks in Israel. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The Company's trade receivables are derived from sales to large and solid organizations located mainly in the United States, Europe and Israel. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to these amounts that the Company has determined to be doubtful of collection. The allowance is computed for specific debts and the collectibility is determined based upon the Company's experience.

The Company granted loans in prior years to its former CEO and a former officer amounting to approximately $ 983 as of December 31, 2006 and 2005. These loans are partly unsecured and the Company is currently in litigation with these officers regarding such loans. If not paid, the Company will incur a loss equal to the amount of the loan, net of a provision recorded against the loan.

The Company has no off-balance sheet credit risks.

o. Warranty:

In connection with the sale of its products, the Company provides product warranties for periods between one to two years. Based on past experience and engineering estimates, the liability from these warranties is immaterial at balance sheet date.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

p. Share-based compensation:

At December 31, 2006, the Company has three stock-based employee compensation plans, which are described in Note 11b. Prior to January 1, 2006, the Company accounted for those plans under the recognition and measurement provisions of APB 25, "Accounting for Stock Issued to Employees", and related Interpretations, as permitted by FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). In general, as the exercise price of options granted under these plans was equal to the market price of the underlying common stock on the grant date, no stock-based employee compensation cost was recognized in the statements of operations for the years ended December 2005 and 2004.

Effective January 1, 2006, the Company adopted FASB Statement No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)") , and related Securities and Exchange Commission rules included in Staff Accounting Bulletin No. 107, on a modified prospective basis. Under this method, compensation cost recognized in 2006 includes costs related to 1) all share-based payments granted prior to but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123 and 2) all share-based payments granted subsequent to January 1, 2006 based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated statements of operations. Results for prior periods have not been restated.

The Company had unvested options granted to employees upon its adoption of SFAS 123(R) on January 1, 2006. The impact of the adoption of SFAS 123(R) on January 1, 2006 was an increase of approximately $ 75 thousand on the Company's net loss and $ 0.01 on the basic and diluted net loss per share for the year ended December 31, 2006.

RADA ELECTRONIC INDUSTRIES LTD.AND ITS SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

The following table illustrates the effect on net income (loss) and net earnings (loss) per share, assuming that the Company had applied the fair value recognition provisions of SFAS 123 to options granted under the Company's stock options plans in all periods presented prior to the adoption of SFAS 123(R). For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes-Merton option-pricing model and amortized to expense over the options' vesting periods.

	YEAR ENDED DECEMBER 31,	
	2005	2004
Net income (loss), as reported	$(2,329)	$ 822
Deduct - total stock-based employee compensation expense under fair value based methods	(136)	(73)
Pro forma net income (loss)	$(2,465)	$ 749
Net earnings (loss) per share:		
Basic net earnings (loss) per share as reported	$ (0.31)	$ 0.12
Pro forma basic net earnings (loss) per share	$ (0.33)	$ 0.12
Diluted net earnings (loss) per share as reported	$ (0.31)	$ 0.09
Pro forma diluted net earnings (loss) per share	$ (0.33)	$ 0.09

The Company estimates the fair value of stock options on the grant date using the Black-Scholes-Merton option-pricing model with the following weighted average assumptions:

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
Expected term	4 years	4 years	2 years
Dividend yield	0%	0%	0%
Expected volatility	54%	66%	68%
Risk-free interest rate	4.7%	4.4%	2.6%
Estimated forfeitures	10%	-	-

RADA ELECTRONIC INDUSTRIES LTD.AND ITS SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

The risk-free interest rate assumption is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term as of the Company's employee stock options. The dividend yield assumption is based on the Company's historical and expectation of future dividend payouts and may be subject to substantial change in the future. The expected term of the options represents the period of time that the options are expected to be outstanding and is based on the Company's historical information, with respect to employee options exercised. The Company used its historical volatility for calculating volatility in accordance with SFAS 123 (R). Estimated forfeitures are based on actual historical pre-vesting forfeitures.

q. Revenue recognition:

The Company generates revenues mainly from the sale of products and from long-term fixed price contracts for ATE, avionics and ground debriefing systems. In addition, the Company leases ATE to customers and provides manufacturing, development and product support services.

PRODUCT REVENUES:

The Company recognizes revenue from sales of products and aircraft spare parts in accordance with Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition". Product revenue is recognized when there is persuasive evidence of an arrangement, the fee is fixed or determinable, delivery of the product to the customer has occurred and the Company has determined that collection of the fee is probable. If the product requires specific customer acceptance, revenue is deferred until customer acceptance occurs or the acceptance provisions lapse, unless the Company can objectively and reliably demonstrate that the criteria specified in the acceptance provisions are satisfied.

Revenues from certain long-term fixed price contracts are recognized in accordance with Statement of Position No. 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" ("SOP 81-1"), using contract accounting on a percentage of completion method in accordance with the "Input Method". The percentage of completion is determined based on the ratio of actual costs incurred to total costs estimated to be incurred over the duration of the contract. With regard to contracts for which a loss is anticipated, a provision is made for the entire amount of the estimated loss at the time such loss becomes evident. As of December 31, 2006, the provision for estimated losses identified is $ 104.

Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit or loss are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

The Company believes that the use of the percentage of completion method is appropriate as the Company has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement. In all cases, the Company expects to perform its contractual obligations and its licensees are expected to satisfy their obligations under the contract.

According to SOP 81-1, costs that are incurred and are directly associated with a specific anticipated contract are being deferred, subject to evaluation of their probable recoverability, and recorded as unbilled contract costs.

Revenues from certain arrangements may include multiple elements within a single contract. The Company's accounting policy complies with the provisions of Emerging Issues Task Force Issue 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"), relating to the separation of multiple deliverables into individual accounting units with determinable fair value. The Company's arrangements are accounted for as separate units of accounting when it is possible to determine objective and reliable evidence of fair value of the undelivered elements in order to separate the fees among the elements. Revenue is recognized when the element is delivered and all other criteria for revenue recognition are met.

The Company accounts for software sales (TPSs) in accordance with Statement of Position No. 97-2, "Software Revenue Recognition ("SOP No. 97-2"), as amended. Revenue from software arrangements is recognized when persuasive evidence of an arrangement exists, delivery of the product has occurred, the fee is fixed or determinable, and collectability is probable. Arrangements with payment terms extending beyond customary payment terms are considered not to be fixed or determinable. If the fee is considered not to be fixed or determinable, revenue is deferred and recognized when payment becomes due from the customer or are actually collected when collectability is not probable, providing that all other revenue recognition criteria have been met.

SERVICE REVENUES:

Revenues from services are recognized as the services are performed.

Revenue under operating leases of equipment are recognized ratably over the lease period, in accordance with Statement of Financial Accounting Standard No. 13, "Accounting for Leases" ("SFAS No. 13").

Deferred revenues include unearned amounts received from customers, but not yet recognized as revenues.

RADA ELECTRONIC INDUSTRIES LTD.AND ITS SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (CONT.)

r. Basic and diluted net earnings (loss) per share:

Basic net earnings (loss) per share are computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (loss) per share are computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share". Options and warrants to purchase 5,335,037 Ordinary shares have been excluded from the computation of diluted net earnings per share for the year ended December 31, 2004, since their effect is anti-dilutive. For the years ended December 31, 2006 and 2005, all outstanding options and warrants have been excluded from the computation of diluted net loss per share, since their effect is anti-dilutive.

s. Recently issued Accounting Standards:

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements". This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Management believes this Standard will not have a material effect on its consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), an interpretation of SFAS 109, "Accounting for Income Taxes". FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions shall initially be recognized in the financial statements when it is more-likely-than-not the position will be sustained upon examination by the tax authorities. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements to include an annual tabular rollforward of unrecognized tax benefits. The provisions of this Interpretation are required to be adopted for fiscal periods beginning after December 15, 2006. The Company will be required to apply the provisions of FIN 48 to all tax positions upon initial adoption with any cumulative effect adjustments to be recognized as an adjustment to retained earnings. Based on Company's initial evaluation as of December 31, 2006, the Company does not believe that FIN 48 will have a material impact on its financial statements.

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," ("SFAS No. 159"), which permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS No. 159 no later than January 1, 2008. The Company has not yet determined the effect that the adoption of SFAS No. 159 will have on its consolidated financial statements.

NOTE 3:- CONTRACTS IN PROGRESS

Amounts included in the financial statements, which relate to costs and estimated earnings in excess of billings on uncompleted contracts are classified as current assets. Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. Summarized below are the components of the amounts:

a. Costs and estimated earnings in excess of billings on uncompleted contracts:

	DECEMBER 31,	
	2006	2005
Costs incurred on uncompleted contracts	$ 6,758	$ 7,625
Estimated earnings	1,612	435
	5,146	7,190
Less - billings and progress payments	4,478	5,794
	$ 668	$ 1,396

b. Billings in excess of costs and estimated earnings on uncompleted contracts:

Costs incurred on uncompleted contracts	$ 3,706	$ 7,426
Estimated earnings	2,005	1,380
	5,711	8,806
Less - billings and progress payments	5,996	9,197
	$ (285)	$ (391)

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

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NOTE 4:- INVENTORIES

	DECEMBER 31, 2006	2005
Raw materials and components	$1,852	$1,348
Work in progress	523	541
Finished goods	93	53
	$2,468	$1,942

Write-offs of inventories for the years ended December 31, 2006, 2005 and 2004 amounted to $ 29, $ 342 and $ 0, respectively. The write-offs in 2006 and 2005 was due to slow-moving items and excess inventories and was presented as cost of revenues.

NOTE 5:- LONG-TERM RECEIVABLES

	DECEMBER 31, 2006	2005
Loan to former chief executive officer	$705	$705
Loan to a former officer	278	278
	$983	$983

See also Note 10a.

NOTE 6:- PROPERTY, PLANT AND EQUIPMENT, NET

	DECEMBER 31, 2006	2005
Cost:		
Factory building	$ 1,940	$ 1,940
Other building	1,042	1,042
Machinery and equipment	14,001	13,785
Office furniture and equipment	541	521

Leasehold improvements	23	23
	17,547	17,311
Accumulated depreciation:		
Factory building	1,320	1,275
Other building	310	263
Machinery and equipment	12,140	11,453
Office furniture and equipment	396	368
Leasehold improvements	22	21
	14,188	13,380
Depreciated cost	$ 3,359	$ 3,931

The Company's factory building in Beit-She'an, Israel, is located on land leased from the Israel Lands Administration until 2034.

Depreciation expense amounted to $ 808, $ 825 and $ 778 for the years ended December 31, 2006, 2005 and 2004, respectively.

As for charges, see Note 10e.

RADA ELECTRONIC INDUSTRIES LTD.AND ITS SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 7:- INTANGIBLE ASSETS, NET AND GOODWILL

		DECEMBER 31, 2006			DECEMBER 31, 20	
	USEFUL LIFE (YEARS)	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	AMORTIZED BALANCE	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
Amortized intangible assets:						
Test Systems Programs Sets ("TPS")	5 - 10	$8,275	$ *) 7,135	$1,140	$8,275	$6,841
Customer relationships	5	1,263	497	766	1,263	228
Total		$9,538	$ 7,632	$1,906	$9,538	$7,069

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

*) Includes impairment charges of $ 19.

Amortization expense was $ 544, $ 503 and $ 275 for the years ended December 31, 2006, 2005 and 2004, respectively. The expected amortization expense over the next six years is approximately as follows:

2007	$ 500
2008	421
2009	421
2010	211
2011 and thereafter	353
	$ 1,906

The weighted average useful life of the intangible assets is five years. Impairment of Test System Programs Sets ("TPSs") was $ 19, $ 0 and $ 0 for the years ended December 31, 2006, 2005 and 2004, respectively and included in cost of revenues. The impairment of $ 19 was recorded in 2006 since the Company does not anticipate future revenues on certain specific TPSs.

In 2006, the Company recorded $ 166 of goodwill in respect of additional consideration payable in connection with the acquisition of Vectop relating to royalties due based on actual revenues derived from Vectop projects.

NOTE 8:- SHORT-TERM BANK CREDIT AND LOANS

a. Short-term bank credit:

	DECEMBER 31,	
	2006	2005
Short-term:		
Bank credit in NIS (1)	$238	$166
Bank credit in U.S. dollars (2)	-	11
	$238	$177

(1) The interest rate at December 31, 2006 is 8.85% (December 31, 2005 - 9.3%).

(2) The interest rate at December 31, 2005 is 13.6%.

The revolving line of credit is due in December 2007 and will be renewed on an annual basis.

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

As for collaterals, see Note 10e.

b. Long-term loans

	DECEMBER 31, 2006	DECEMBER 31, 2005
Loan in NIS (1)	$288	$ -
Loan in U.S. dollars (2)	175	700
	$463	$700
Current maturities		
Loan in NIS (1)	$146	$ -
Loan in U.S. dollars (2)	175	700
	$321	$700

(1) The principal of the loan is due in 21 monthly installments from March 2007 until November 2008 and the interest is payable monthly from February 2007. The interest rate at December 31, 2006 is 8.6%.

(2) The principal of the loan is due in 15 monthly installments from January 2006 until April 2007 and the interest is payable monthly from March 2005. The interest rate at December 31, 2006 and 2005 is 5.1%.

The Company's line of credit (including loans) is $ 763, out of which $ 701 was utilized at December 31, 2006.

NOTE 9:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	DECEMBER 31, 2006	DECEMBER 31, 2005
Payroll and related accruals	$ 953	$ 980
Provision for legal proceedings	561	576
Accrued royalties	861	691
Accrued commissions	294	338
Contracts in progress - provision for estimated losses	104	68

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

Accrued expenses	401	539
Other	245	25
	$3,419	$3,217

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES

a. As of December 31, 2006, the Company was a party to various legal proceedings, including the following:

1. In June 1998, the Company's Board accepted the resignation of the Company's former CEO. In December 1998, the former CEO commenced legal proceedings against the Company in the Tel-Aviv Labor Court, claiming approximately $ 440 in respect of salary, severance pay, vacation pay and other fringe benefits. The former CEO also claimed that a personal loan that was provided to him by the Company had been forgiven and that the Company is to bear the tax in respect thereof. In May 2001, an additional claim of approximately $ 220 was filed by the former CEO against the Company in the Tel-Aviv District Court for damages allegedly caused to him as a result of attachment imposed on certain of his assets by the Company that was subsequently cancelled by the Court. In addition, in 2001, the Company filed a claim against a former director. In the event the former CEO's claim in the Labor Court is accepted by the Court, damages in the amount of $ 250 should be covered by the former director. The Company filed additional lawsuits against the former CEO and a former director in the amount of $ 260 for funds that they allegedly transferred from the Company to a third party. In September 1999, the Company filed a lawsuit against the former CEO and the former director with the District Court of Tel-Aviv in the amount of $ 1,400 for damages caused to the Company in the purchase of a subsidiary and negligence of management. In August 2000, the Company filed an additional lawsuit against the former CEO in the amount of approximately $ 440 regarding the repayment of the loan provided to him. Management believes, based on the advice of its legal counsel, that the Company has a strong defense against all claims made against it.

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES

2. In 1999 and 2000, the former CEO and his son filed a number of complaints against the Company's president and are seeking damages for alleged slander by him in the amount of approximately $ 750. The claim by the former CEO was withdrawn and replaced by a new claim filed in 2004, for an amount of NIS 1 million ($ 235 at December 31, 2006) while his son's claim was dismissed and an appeal to the Supreme Court was withdrawn. Management believes,

based on the advice of its legal counsel, that the Company has a strong defense against the allegations and, accordingly, did not record any provision.

3. In 2001, a former employee and officer of the Company filed a claim against the Company with the Tel-Aviv Labor Court claiming approximately $ 520 in respect of severance pay, vacation pay and other fringe benefits. This claim was filed as a counter-claim to a claim filed by the Company in 2000, in the amount of $ 260 in respect of the repayment of a personal loan that was provided to the former employee. The Company's claim was allowed in part while the employers' claim was dismissed. The Company appealed to the National Labor Court.

4. In 2001, a former director filed a claim against the Company, claiming that he is entitled to 200,000 (after the reverse split) options to purchase Ordinary shares of the Company. Management believes, based on the advice of its legal counsel, that the claim does not have any merit and, accordingly, did not record any provision.

5. In 2000, a claim was filed by an Israeli firm against the Company, claiming that it served as a broker in an agreement signed between the Company and a potential investor and is entitled to commissions (or finder's fee) in the amount of $ 250. The claim was dismissed by the Court and Plaintiff appealed to the Supreme Court. Management believes, based on the advice of its legal counsel, that there is no merit to the appeal.

6. In 2005, the former CEO of the Company filed a claim against the Chairman of the Company (in respect of which the Chairman is entitled to indemnification) alleging that the Chairman has committed fraud and negligent misrepresentation of him. The former CEO claims that, as a result, he was compelled to retire from his position, resulting in a loss of a salary and benefits in the aggregate amount of approximately $ 565. Management believes, based on the advice of its legal counsel, that there is no merit to the claim and that the Company has a strong defense against the allegations and, accordingly, did not record any provision.

7. In 2006, the former CEO filed a claim against two of the Board members seeking damages in the amount of NIS 0.5 million ($ 118 at December 31, 2006). In essence, this claim is identical to the claim against the Company and against its Chairman, which is described in 6 above. Defense has not as yet been submitted on behalf of the defendants, since the issue of the competency of the Court has to be decided first.

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (CONT.)

8. In 2006, the Company filed a suit before an arbitrator seeking to recover $ 445 from Parado Technologies Ltd., formerly known as Vectop Ltd. ("Vectop"). Consequently, Vectop counterclaim seeking an order that the Company will transfer an amount of $ 181 to a trust account and with respect to royalties due to Vectop for 2005 and 2006.

   In accordance with the agreement with Vectop (see Note 1d), Vectop is entitled to receive payments contingent upon sales made by the Company of Vectop's products. According to the agreement, the first $ 200 due to Vectop should have been transferred to a trust account for the purpose of indemnifying the Company for possible future damages.

   In the claim against Vectop, the Company asserts that it is entitled to compensation because of misrepresentations made by Vectop during the negotiations, in connection with five of the products sold by Vectop. It is alleged that Vectop breached the agreement, by not providing timely financial statements reconciled to US GAAP. The Company asserts that it has a right of off-set against payments due to Vectop under the agreement.

   Vectop alleges that the Company is obliged to transfer to the trust account the part of the immediate payment of royalties due from the 2005 sales and that it can only be indemnified from this trust account under a final decision of the arbitrator. The Company believes that there is a possibility that the arbitrator will order the transfer of said amount to the trust account until a final award is made. As for the outcome of the arbitration, management believes, based on the advice of its legal counsel, that the matter is still in its early stages and it is therefore not possible to assess the risk involved in Vectop's claim.

9. The Company is involved periodically in various legal claims in the ordinary course of business, including claims by agents and others for commissions, royalties and others. The Company has accrued an amount which it believes is sufficient to cover damages, if any, that may result from these claims. The Company's management, based on the advice of its legal counsel, believes that such claims will not have a material adverse effect on the financial position or results of operations of the Company.

NOTE 10:- COMMITMENTS AND CONTINGENT LIABILITIES (CONT.)

b. The Company's research and development efforts have been partially financed through royalty-bearing programs sponsored by the Office of the Chief Scientist of Israel's Ministry of Industry, Trade and Labor ("OCS"). In return for the OCS's participation, the Company is committed to pay royalties at a rate ranging from 3% to 5% of sales of the products whose research was supported by grants received from the OCS, up to 100% of the amount of such participation received linked to the U.S. dollar. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, no payment is required. The Company's total obligation for royalties, net of royalties paid or accrued, totaled approximately $ 685 as of December 31, 2006. The total amount of royalties charged to operations for the years ended December 31, 2006, 2005 and 2004 was approximately $ 17, $ 27 and $ 60, respectively.

c. Research and development projects undertaken by the Company were partially financed by the Binational Industrial Research and Development Fund ("BIRD") Foundation. The Company is committed to pay royalties to the BIRD Foundation at a rate of 5% of sales proceeds generating from projects for which the BIRD Foundation provided funding up to 150% of the sum financed by the BIRD Foundation. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, no payment is required. The Company's total obligation for royalties, net of royalties paid or accrued, totaled approximately $ 2,097 as of December 31, 2006. The total amount of royalties charged to operations for the years ended December 31, 2006, 2005 and 2004 was approximately $ 14, $ 12 and $ 20, respectively.

d. The Company's offices in Netanya are rented under a non-cancelable operating lease expiring January 31, 2008. In addition, the Company's motor vehicles are rented under operating leases. Annual minimum future rental commitments under these leases, at exchange rates in effect on December 31, 2006, are approximately as follows:

2007	$ 721
2008	492
2009	94
	$ 1,307

Lease expense for the years ended December 31, 2006, 2005 and 2004 was $ 479 $ 471 and $ 508, respectively.

e. Floating charges have been recorded on all of the Company's assets and specific charges have been recorded on certain assets in respect of the Company's liabilities to its banks and other creditors.

f. The Company provides bank guarantees to its customers in the ordinary course of business. These guarantees are provided to customers to secure advances received at the commencement of a project or to secure performance of operational milestones. The total amount of bank guarantees provided to customers as of December 31, 2006 is approximately $ 1,354.

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 11:- SHAREHOLDERS' EQUITY

a. Share capital:

Ordinary shares confer upon their holders voting rights, the right to receive cash dividends and the right to share in excess assets upon liquidation of the Company.

In February 2007, the Company effected a 3 to 1 reverse stock split with respect to its Ordinary shares. All shares, stock options, warrants and net earnings (loss) per share amounts in these financial statements have been restated for all prior periods to reflect the reverse stock split.

In April 2005, the Company completed a private placement to institutional investors. The Company issued 321,978 Ordinary shares for total proceeds of $ 1,091 ($ 1,006 net of issuance expenses) and warrants to purchase up to an aggregate of 625,000 Ordinary shares at an exercise price of $ 6.30 per share. At the same time, the investors exercised additional investment rights to purchase 303,022 of the Company's Ordinary shares at an exercise price of $ 6.30 per share, for total amount of $ 1,909 ($ 1,761 net of issuance expenses) (see also c. below).

In July 2004, the Company issued 600,000 shares, an aggregate of $ 3,000 principal amount of convertible notes, additional investment rights to purchase up to an aggregate of 366,667 Ordinary shares at an exercise price of $ 6.30 per share, (with a term of two years commencing six months following the closing) and warrants to purchase up to an aggregate of 312,500 Ordinary shares at an exercise price of $ 7.50 per share (for a term of five years commencing six months following the closing) to investors in a private placement for a total consideration of $ 5,880 ($ 5,712 net of issuance expenses) (see also c. below).

The consideration was allocated based on the relative fair values of the Ordinary shares, notes, additional investment rights and warrants in accordance with APB No. 14, "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants". The convertible notes bear interest at a rate of six-month LIBOR plus 2.5%. The principal is due in July 2007 and the interest is payable in quarterly installments until July 2007. The notes are convertible to Ordinary shares at a conversion price of $ 6.30. In connection with the issuance of the notes, additional investment rights and warrants, $ 180 was recorded as a beneficial conversion feature in accordance with EITF 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios".

NOTE 11:- SHAREHOLDERS' EQUITY (CONT.)

The total amount of the deemed discount on the notes as a result of the allocated proceeds attributable to the warrants, additional investment rights and the beneficial conversion feature amounting to $ 760, is amortized over the term of the notes using the interest method. At December 31, 2006, the unamortized balance on the deemed discount on the convertible notes was $ 142. The fair value of the warrants and additional investment rights was based on a valuation prepared using the Black-Scholes-Merton option-pricing model, assuming a risk free interest of 2.64% and 3.69%, respectively, a volatility factor of 0.67 and 0.68, respectively, dividend yield of 0% and contractual life of two years and five years, respectively. In addition, the valuation considered that the warrants and additional investment rights were restricted for the first six months, the warrants were not traded on the market at any time, and the underlying asset had a low marketability. The valuation result was judged to be reasonable by comparison to benchmarks in similar circumstances. The Company's management is responsible for the valuation.

Costs incurred with respect to the issuance of the convertible notes of $ 69 have been recorded as deferred charges and are amortized as financial expenses over the term of the notes using the interest method.

b. Stock option plans:

In 1996, 1999 and 2003, the Company's Board approved the adoption of Employee Stock Option Plans ("the Plans"), which authorized the grant of options to purchase up to an aggregate of 80,000, 346,667 and 1,166,667 Ordinary shares (in 2006 the Company's Board approved increase of the 2003 plan by an additional 500,000 options), respectively, to officers, directors, consultants and key employees of the Company and its subsidiary. Options granted under the Plans expire within a maximum of 10 years from adoption of the plan. One third of the options granted under the Company's Plans vest immediately on the grant date and the remaining two third vests ratably over two years. Compensation expense is recognized by the straight-line method.

The exercise price of an option granted to an employee may not be less than 60% of the fair market value of the Ordinary shares on the date of grant of the option. The exercise price of an option granted to a non-employee director or consultant may not be less than 80% of the fair market value of the Ordinary shares on the date of grant of the option. Any options that are cancelled or forfeited before expiration become available for future grants. At December 31, 2006, 166,432 options were available for grant under the Plans described above. Upon exercise of options by employees, the Company satisfies the requirements by issuing newly issued shares.

NOTE 11:- SHAREHOLDERS' EQUITY (CONT.)

Transactions related to the above Plans (including warrants to directors) during the year ended December 31, 2006 were as follows:

	YEAR ENDED DECEMBER 31, 2006			
	AMOUNT OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	WEIGHTED AVERAGE REMAINING CONTRACTUAL TERM (IN YEARS)	AGGREGATE INTRINSIC VALUE
Options outstanding at beginning of year	705,300	$ 3.79	5.29	$ -
Granted	400,000	$ 2.40	6.07	$ -
Exercised	(13,833)	$ 2.07	6.07	$ -
Expired	(11,467)	$ 4.09	-	$ -
Forfeited	(22,533)	$ 3.70	4.52	$ -
Options outstanding at end of year	1,057,467	$ 3.31	4.85	$ -
Vested and expected to vest at December 31, 2006	1,025,864	$ 3.34	4.82	$ -
Exercisable options at end of year	759,578	$ 3.63	4.47	$ -

No share-based employee compensation expense was recorded for the years ended December 31, 2005 and 2004 under APB 25. Share based compensation for the year ended December 31, 2006 was $ 221.

The weighted-average grant-date fair value of options granted during the years ended December 31, 2006, 2005 and 2004 was $ 0.34, $ 0.55 and $ 0.44, respectively. The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the Company's closing stock price on December 31, 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2006. Total intrinsic value of options exercised for the years ended December 31, 2006, 2005 and 2004 was $ 13, $ 98 and $ 183, respectively. As of December 31, 2006, there was $ 270 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's stock option plans. That cost is expected to be recognized over a weighted-average period of one year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 11:- SHAREHOLDERS' EQUITY (CONT.)

The options outstanding as of December 31, 2006 have been separated into ranges of exercise prices, as follows:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICE	AT DECEMBER 31, 2006	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (IN YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	AT DECEMBER 31, 2006	WEIGHTED AVERAGE EXERCISE PRICE
$ 2.07 - 3.00	586,000	5.02	$ 2.30	319,334	$ 2.21
$ 3.87 - 6.00	436,667	5.21	$ 3.97	405,444	$ 4.00
$ 9.28 - 12.38	24,133	1.42	$10.16	24,133	$10.16
$ 14.63 - 20.25	10,667	1.5	$16.88	10,667	$16.88
	1,057,467		$ 3.31	759,578	$ 3.63

c. Warrants:

As of December 31, 2006, warrants to purchase 5,493,282 Ordinary shares were outstanding.

In April 2005, in connection with the issuance of Ordinary shares described in a. above, the Company granted the purchasers of the Ordinary shares, warrants to purchase up to an aggregate of 625,000 Ordinary shares at $ 6.30 per share, which expire on the later of (i) 24 months from the date of the grant, and (ii) 24 months from the date of the shareholder approval, ratifying the issuance of the Ordinary shares and the warrants under the Securities Purchase Agreement to the selling shareholders and authorizing the increase of the Company's authorized Ordinary shares from 15,000,000 Ordinary shares to no less than 15,833,333 Ordinary shares

In July 2004, in connection with the issuance of Ordinary shares and convertible notes described in a. above, the Company granted the investors additional investment rights to purchase up to an aggregate of 366,667 Ordinary shares at an exercise price of $ 6.30 per share, (with a term of two years commencing six months following the closing) and warrants to purchase up to an aggregate of 312,500 Ordinary shares at an exercise price of $ 7.50 per share (for a term of five years commencing six months following the closing). In April 2005, 303,022 additional investment rights were exercised.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 12:- TAXES ON INCOME

a. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes are measured and adjusted in accordance with the change in the CPI. As explained in Note 2b, the consolidated financial statements are presented in U.S. dollars. The differences between the change in the Israeli CPI and in the NIS/U.S. dollar exchange rate cause a difference between taxable income or loss and the income or loss before taxes reflected in the consolidated financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on this difference between the financial reporting basis and the tax bases of assets and liabilities.

b. Tax benefits under the Law for the Encouragement of Industry (Taxes), 1969:

The Company is an "Industrial Company" under the Law for the Encouragement of Industry. The principal benefit from the above law is the deduction of expenses in connection with a public offering.

c. Tax rates applicable to income of companies in Israel:

In June 2004, an amendment to the Income Tax Ordinance (No. 140 and Temporary Provision), 2004 was passed by the "Knesset" (Israeli parliament) and on July 25, 2005, another law was passed, the amendment to the Income Tax Ordinance (No. 147) 2005, according to which the corporate tax rate is to be progressively reduced to the following tax rates: 2004 - 35%, 2005 - 34%, 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26%, 2010 and thereafter - 25%.

d. As of December 31, 2006, the net operating tax loss carryforward relating to the Company in Israel amounted to approximately $ 49,000, including a carryforward capital loss amounting to approximately $ 2,955. Carryforward losses in Israel may be carried forward indefinitely and may be offset against future taxable income.

As of December 31, 2006, carryforward tax losses relating to the subsidiary (in China), amounted to approximately $ 239.

As the Company believes that it is more likely than not that the tax assets in respect of these carryforward losses amounting to approximately $ 15,300 will not be utilized, the Company recorded a valuation allowance for the entire balance of the deferred tax asset relating to the carryforward losses.

e. The main reconciling items between the statutory tax rate of the Company and the effective tax rate is the valuation allowance recorded in respect of the tax assets relating to net operating loss carryforward and other temporary differences due to the uncertainty of the realization of such tax assets.

RADA ELECTRONIC INDUSTRIES LTD.AND ITS SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 12:- TAXES ON INCOME (CONT.)

f. Income (loss) before income taxes:

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
Domestic	$(2,085)	$(2,254)	$ 937
Foreign	85	(75)	(115)
	$(2,000)	$(2,329)	$ 822

NOTE 13:- FINANCIAL EXPENSES, NET

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
Income:			
Foreign currency exchange differences	$ 96	$ 164	$ 234
Interest on cash equivalents and restricted cash	56	20	4
	152	184	238
Expenses:			
Interest on convertible note	231	181	64
Amortization expenses on convertible note and deferred expenses	323	234	115
Foreign currency exchange differences	240	156	79
Interest on loans and other credit balances	35	68	82
Bank commissions	98	100	116
Others	-	69	30
	927	808	486
	$(775)	$(624)	$(248)

NOTE 14:- RELATED PARTY TRANSACTIONS

There are no related party balances as of December 31, 2006 and 2005, and no related party transactions for the years ended December 31, 2006, 2005 and 2004.

NOTE 15:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

a. In accordance with Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information", the Company is organized and operates as one business segment, which develops, manufactures and sells ATE products, avionics equipment and aviation data acquisition and debriefing systems (see Note 1a).

NOTE 15:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION (CONT.)

b. Revenues by geographic areas:

Revenues are attributed to geographic area based on the location of the end customers as follows:

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
North America	$ 4,666	$ 5,096	$ 4,715
Europe	792	586	3,022
Israel	4,265	5,546	4,998
Others	3,314	2,193	1,425
Total	$13,037	$13,421	$14,160

c. Major customers:

Revenues from single customers that exceed 10% of the total revenues in the reported years as a percentage of total revenues, are as follows:

	YEAR ENDED DECEMBER 31,		
	2006	2005	2004
		%	
Customer A	*)	12	19
Customer B	20	14	*)
Customer C	38	21	*)
Customer D	-	*)	10
Customer E	*)	-	11
Customer F	*)	*)	17
Customer G	*)	12	*)

*) Less than 10%.

d. Long-lived assets by geographic areas:

	DECEMBER 31,	
	2006	2005
Israel	$4,518	$5,332
China	926	1,108
	$5,444	$6,440

NOTE 16:- NET EARNINGS (LOSS) PER SHARE

The following table sets forth the computation of basic and diluted net earnings (loss) per share:

	YEAR ENDED DECEM	
	2006	2005
Numerator:		
Net income (loss)	$ (2,000)	$ (2,329
Denominator:		
Weighted average number of Ordinary shares outstanding during the year used to compute basic net earnings (loss) per share (in thousands)	8,723	7,504
Incremental shares attributable to exercise of outstanding options and warrants (assuming proceeds would be used to purchase treasury stock) (in thousands)	-	-
Weighted average number of Ordinary shares outstanding during the year used to compute diluted net earnings (loss) per share (in thousands)	8,723	7,504
Basic net earnings (loss) per share	$ (0.23)	$ (0.31

Diluted net earnings (loss) per share	$ (0.23)	$ (0.31

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S I G N A T U R E S

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

RADA ELECTRONIC INDUSTRIES LTD.

By: /s/ Herzle Bodinger

Herzle Bodinger
President and Chief Executive Officer

Dated: March 29, 2007

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