

TOP IMAGE SYSTEMS LTD
Form 20-F
May 16, 2018

UNITED STATES
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

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

For the fiscal year ended December 31, 2017

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 001-14552

Top Image Systems Ltd.
(Exact name of Registrant as specified in its charter)

Not applicable

(Translation of Registrant's Name into English)

Israel
(Jurisdiction of incorporation or organization)

2 Ben Gurion St, Ramat Gan, 5257334, Israel
(Address of principal executive offices)

Patti Barton

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Top Image Systems Ltd.

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(Name, Telephone, E-mail and/or Facsimile Number and Address of Company Contact Person)

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, nominal value NIS 0.04 per share	The NASDAQ Stock Market LLC

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

None

(Title of Class)

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

None

(Title of Class)

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:

18,167,066 Ordinary Shares

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

Yes No

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

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued Other
by the International Accounting Standards Board

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

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

Yes No

This Form 20-F including all attachments is being incorporated by reference into the Registration Statement on Form S-8 (file no. 333-125064) and the Registration Statements on Form F-3 (file no. 333-119885, 333-175546, 333-193350 and 333-198136).

TABLE OF CONTENTS

	Page
PART I	
<u>ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS</u>	1
<u>ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE</u>	1
<u>ITEM 3. KEY INFORMATION</u>	2
<u>ITEM 4. INFORMATION ABOUT THE COMPANY</u>	17
<u>ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u>	34
<u>ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u>	44
<u>ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u>	50
<u>ITEM 8. FINANCIAL INFORMATION</u>	52
<u>ITEM 9. LISTING</u>	53
<u>ITEM 10. ADDITIONAL INFORMATION</u>	55
<u>ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	75
<u>ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>	75
PART II	
<u>ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	76
<u>ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>	76
<u>ITEM 15. CONTROLS AND PROCEDURES</u>	76
<u>ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT</u>	76
<u>ITEM 16B. CODE OF ETHICS</u>	77
<u>ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	77
<u>ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS OF AUDIT COMMITTEES</u>	77
<u>ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS</u>	77
<u>ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANTS</u>	78
<u>ITEM 16G. CORPORATE GOVERNANCE</u>	78
<u>ITEM 16H. MINE SAFETY DISCLOSURE</u>	78
PART III	
<u>ITEM 17. FINANCIAL STATEMENTS</u>	78
<u>ITEM 18. FINANCIAL STATEMENTS</u>	78
<u>ITEM 19. EXHIBITS</u>	78

Forward-Looking Statements

Certain matters discussed in this Annual Report on Form 20-F (“Form 20-F”) are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that are not historical facts and that reflect our expectations, beliefs, projections, future plans and strategies, anticipated events or trends. For example, statements related to our future financial condition or results of operations, management’s strategies and objectives and expected market growth are forward-looking statements. Forward-looking statements are often characterized by the use of words such as “believes,” “estimates,” “expects,” “projects,” “may,” “will,” “intends,” “plans,” “predicts,” “anticipates,” or “potential” and similar expressions. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements, or industry results to differ materially from historical results or any future results, performance or achievements expressed, suggested or implied by such forward-looking statements. Such risks and uncertainties include, but are not limited to:

- fluctuations in the market price of our ordinary shares;
- potential dilution to the holders of our ordinary shares as a result of future issuances of our securities;
- quarterly fluctuations in our results of operations;
- unstable conditions in the global economy and capital markets;
- future acquisitions that could require significant resources or result in unanticipated adverse consequences;
- whether or not we can successfully complete acquisitions of other businesses and efficiently integrate them, competitive pressures in the data capture and automatic form processing markets;
- the success of our strategic marketing relationships;
- our ability to continue technological innovation and successful commercial introduction of new products;
- the potential for losses;
- our ability to protect intellectual property and other proprietary information;
- the possibility that our ordinary shares could be involuntarily delisted from NASDAQ;
- exposure to currency fluctuations; and
- other risks and uncertainties described in, or incorporated into, this prospectus.

The risks included in this section are not exhaustive. You should carefully consider the section entitled “Risk Factors” in this Form 20-F and other reports we file with or furnish to SEC, which include additional factors that could impact our business and financial performance. If any of these trends, risks or uncertainties actually occurs or continues, our business, financial condition and results of operations could be materially adversely affected.

Forward-looking statements contained in this Form 20-F are based on our current plans, estimates and projections, and, therefore, you should not place undue reliance on them as a prediction of future results. Forward-looking

statements speak only as of the date they are made, and we undertake no obligation to update them in light of new information or future events.

- ii -

Use of Certain Terms

In this report, “we,” “us,” “our,” “TIS” and the “Company” refer to Top Image Systems Ltd. and its consolidated subsidiaries, collectively. References to “\$” and “U.S. dollars” are to the lawful currency of the United States of America. Certain financial information contained in this Form 20-F is presented in thousands where noted.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

1

ITEM 3. KEY INFORMATIONSELECTED FINANCIAL DATA

The following selected consolidated financial data are presented in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. All financial statements included in this annual report are presented solely under U.S. GAAP. The selected consolidated financial data should be read in conjunction with and are qualified by reference to Item 5 of this report entitled "Operating and Financial Review and Prospects" and the consolidated financial statements and notes thereto and other financial information included elsewhere in this report.

	2013	2014	2015	2016	2017
	U.S. dollars in thousands (except share and per share data)				
Statement of Operations Data:					
License Revenues	11,762	11,211	7,708	5,973	5,236
Services Revenues	17,295	24,644	26,083	25,662	24,432
Total Revenues	29,057	35,855	33,791	31,635	29,668
Cost of License Revenues	2,740	1,442	545	701	562
Cost of Services Revenues	9,076	12,880	15,593	16,119	16,093
Total Cost of revenues	11,816	14,322	16,138	16,820	16,655
Gross profit	17,241	21,533	17,653	14,815	13,013
Research and development, net	3,377	4,914	4,797	4,581	4,997
Selling and marketing	9,498	12,967	10,894	7,448	6,586
General and administrative	4,637	6,819	7,492	6,910	6,592
Acquisition related costs	-	1,170	-	-	-
Restructuring Charges	-	-	-	1,142	-
Amortization of intangible assets	-	239	390	502	613
Operating income (loss)	(271)	(4,576)	(5,920)	(5,768)	(5,775)
Financial expense, net	(286)	(352)	(1,145)	(956)	(603)
Other income, net	369	7	4	12	7
Income (loss) from continuing operations before taxes on income	(188)	(4,921)	(7,061)	(6,712)	(6,371)
Taxes (tax benefit) on income	(1)	552	1,215	(115)	(204)
Net income (loss)	(187)	(5,473)	(8,276)	(6,597)	(6,575)
Net profit attributable to non- controlling interest	-	(6)	(19)	(13)	(11)
Net income (loss) attributable to parent company	(187)	(5,479)	(8,295)	(6,610)	(6,586)
Net basic income (loss) per share:	\$ (0.02)	\$ (0.34)	\$ (0.46)	\$ (0.37)	\$ (0.37)
Net diluted income (loss) per share:	\$ (0.02)	\$ (0.34)	\$ (0.46)	\$ (0.37)	\$ (0.37)
Weighted average number of shares outstanding for basic net income (loss) per share	11,718,960	16,071,608	17,870,588	17,925,684	18,006,776
Weighted average number of shares outstanding for diluted net income (loss) per share	11,718,960	16,701,608	17,870,588	17,925,684	18,006,776

As of December 31,

	2013	2014	2015	2016	2017
Summary of Balance Sheet Data:					
Cash and cash equivalents	3,203	4,386	2,404	7,636	2,231
Working capital	8,498	8,974	3,941	4,258	(914)
Total assets	21,647	47,306	40,217	39,639	31,631
Long term debt	1,956	4,355	5,220	8,368	7,763
Total liabilities	5,933	13,469	14,225	19,646	17,463
Shareholders' equity	15,714	33,837	25,992	19,993	14,168

RISK FACTORS

An investment in our ordinary shares involves a high degree of risk. You should consider carefully the following risk factors when making an investment decision. If one or more of the following risks, or risks and uncertainties not currently known to us or that we believe are immaterial, occur, such occurrence(s) could have a material adverse effect on our business, financial condition, results of operations and prospects, the value of our ordinary shares could decline, and you could lose all or part of your investment in our ordinary shares.

Risks Related to Our Business

We have had a history of losses and may incur future losses.

Since our inception in March 1991, we have incurred net losses in every year other than in 1995, 1997, 1998, 2006, 2008, 2011 and 2012, and our losses may recur and continue. As of December 31, 2017, we had an accumulated deficit of approximately \$47 million. We plan to maintain the level of our aggregate product development expenses. We cannot assure you that our revenues will grow or that we will achieve consistent profitability in the future. Failure to increase revenues could result in a material adverse effect on our business, prospects, financial results and results of operations.

If we are unable to achieve and maintain a leading position and to build awareness of our brands, we may not be able to compete effectively against competitors with greater name recognition and our sales could be adversely affected.

If we are unable to economically achieve and maintain a leading position in data recognition software or to promote and maintain our brands, our business, results of operations and financial condition could suffer. Development and awareness of our brands will depend largely on our success in increasing our customer base. In order to attract and retain customers and to promote and maintain our brands in response to competitive pressures, we may be required to increase our marketing budget or increase our sales expenses. There can be no assurance that our efforts will be sufficient or that we will be successful in attracting and retaining customers or promoting our brands.

Our capital requirements have historically been significant and we may not be able in the future to meet our requirements with our working capital.

Historically, our capital requirements have been significant.

In May 2018, in order to provide the Company with additional liquidity if needed, we entered into a term sheet (the "Term Sheet") with Hale Capital Partners which provides for a new senior secured term loan of up to \$3 million (the "Senior Loan") as part of a secured credit facility (the "Credit Facility") that would include the existing convertible note held by an affiliate of Hale in an amount of \$5.6 million. The Senior Loan would be required to be prepaid on certain events and would be prepayable at the Company's option at a premium beginning one year following closing.

In December 2016, we borrowed \$5 million from HCP-FVE, LLC, an affiliate of Hale Capital Partners in exchange for a convertible promissory note (the "Convertible Note") which bears interest at the prime rate plus 2.5% (if paid in cash) or 3% (if the interest capitalized) per annum and matures (if not converted prior) in December 2020. As of March 31, 2018, the principal amount of the Convertible Note is convertible into 3,094,998 of our ordinary shares. Upon withdrawal from the Credit Facility, the Convertible Note, plus accrued interest, will be exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0%.

The Company has not yet determined if it will draw on the Credit Facility. The issuance of the warrants and the changes to the Convertible Note are conditioned upon the drawing down of the Credit Facility. If the Company elects not to withdraw funds out of the Credit Facility, it will be obligated to pay to Hale Capital Partners, LP a break up fee

of equal to three percent (3%) of the Credit Facility.

In December 2017, we secured a \$2.5 million line of credit with a U.S. based bank. The line was secured by the accounts receivables of our U.S. subsidiary and bore interest at 2.5% or 3% (if in stream line mode) per annum and matured in December 2018. We had borrowings outstanding of \$0.8 million against the line of credit at December 31, 2017. Subsequent to December 31, 2017, the borrowings under the line were repaid and the line was cancelled.

We may require additional financing in the future to fund our operations and capital requirements. In such event, we cannot assure you that additional financing will be available to us when needed, on commercially reasonable terms, or at all. We have no expectation that our existing shareholders will provide any portion of our future financing requirements. Any inability to obtain additional financing when needed would have a material adverse effect on us, requiring us to curtail our expansion efforts. In addition, our current and possible future indebtedness, subjects us to risks associated with such substantial indebtedness, including the risk that interest rates may fluctuate or that we may have insufficient resources to repay interest and principal on any such indebtedness. Any additional equity financing may involve substantial dilution of the interests of our then-existing shareholders.

Volatility in the European Union and questions about its future may negatively affect our European operations.

On June 23, 2016, the United Kingdom held a referendum in which voters approved an exit from the European Union, commonly referred to as “Brexit”. As a result of the referendum, the British government and the European Union have begun negotiating the terms of the United Kingdom’s future relationship with the European Union. Although it is unknown what those terms will be, it is possible that there will be greater restrictions on imports and exports between the United Kingdom and European Union countries and increased regulatory complexities. Uncertainties arising from Brexit have resulted in financial volatility in Europe and fluctuations in some of the currencies in which we do business have been attributed to questions about Brexit. In addition, speculation about the future of European Union has led to further uncertainty in the markets. These developments may have an impact on both our European and worldwide operations and could have a material adverse effect on our business, prospects and financial condition.

The European credit markets, which had a negative impact on the European economy in recent years and experienced an increase in availability of funds and lower borrowing costs in 2017, may have adverse impact on our operations. In 2015, 2016 and 2017 we generated \$14.1 million, \$10.2 million and \$9.5 million respectively, of revenues from our operations in Europe, which represented 42%, 32% and 32% respectively, of our total revenues. We are not certain that we will be able to maintain those levels in light of the ongoing economic uncertainty in Europe. The uncertainty in the Euro Zone may result in additional deterioration of our customers’ and end-users’ credit quality or access to cash, which could lower the realization rate on our accounts receivable. Economic difficulties in Europe could lead to the lower demand for such products or services, increase our exposure to losses from bad debts or result in our customers or end-users ceasing operations, any of which could materially adversely affect our business, financial condition and results from operations.

The market for data capture systems, automatic form processing systems and mobile data captures is highly competitive.

The market for data capture systems in general, and for automatic form processing systems in particular, is characterized by intense competition, significant price erosion over the life of the product, and rapidly changing business conditions, customer requirements, and technology. Our products compete with those developed and marketed by numerous well-established companies, including Kofax, Ephesoft, Esker, Itesoft, Nuance, Mitek Systems, Bancotec, EMC (Captiva Software), IBM Datacap, Delux (Wassau) as well as with manual data entry solutions. Many of our competitors have longer operating histories and greater financial resources than we do. Furthermore, certain of these competitors are industry leaders with the financial resources necessary to enable them to withstand substantial price competition or downturns in the market for computer software. The fact that our resources are more limited places us at a significant disadvantage. This risk is particularly acute during difficult economic times. Further, the emerging market for mobile data capture systems in which we are competing, even at this stage of its development, is characterized by intense competition and rapidly changing business conditions, customer requirements, and technology. The emerging nature of the market may impose financial risks that competitors with greater financial resources are more equipped to bear.

A slowdown in our customers' industries could adversely impact the sale of our products and our prospects of achieving or maintaining profitability.

A slowdown in the industries to which we sell our products would likely result in significantly reduced product demand, erosion of selling prices and overcapacity. Such a downturn could materially reduce demand for the products and technology that we offer. In addition, our ability to reduce expenses in response to any downturn or slowdown in such industries may be limited because of:

- our continuing need to invest in research and development;
- our capital equipment requirements; and
- marketing requirements.

A slowdown could have a material adverse effect on our business, prospects, financial condition and results of operations.

The impact of the global economy may have a material adverse effect on our business, results of operations and financial condition.

We sell our products and services in various countries around the world, with a significant concentration in Europe and North America. Consequently, our sales and profitability are dependent on economic conditions globally and in each market we operate in. Changes in consumer and corporate confidence, declines in income and asset values and other adverse factors related to the global economy could result in our customers and the end-users of our products, services and solutions, postponing or reducing spending on our products, services and solutions. Should those conditions occur, they might adversely affect our business.

Changes in the global economy could lead to a reduced availability of credit which could have a negative impact on the financial condition, and in particular on the purchasing ability, of some of our customers and may also result in requests for extended payment terms, credit losses, insolvencies, limited ability to respond to demand or diminished sales channels available to us. Changes in the global economy combined with a tightening in credit markets could also cause financial difficulties for our suppliers and collaborative partners which may result in their failure to perform as planned and, consequently, in delays in the delivery of our products, services and solutions.

Changes in global economic conditions may also result in inefficiencies due to our reduced ability to forecast developments in our industry and plan our operations accordingly. Adverse economic conditions affecting us, our current and potential customers, their spending on our products, services and solutions, and our suppliers and collaborative partners may have a material adverse effect on our business, results of operations and financial condition.

Our success depends on our strategic marketing relationships and the marketing and distribution efforts of our distributors and other strategic partners.

Our business and prospects depend upon our ability to maintain our existing, and to develop additional, strategic marketing relationships and upon the marketing and distribution efforts of our distributors and other strategic partners. The loss or diminishment of our relationship with any one of our significant strategic partners could have a material adverse effect on our existing operations and growth prospects. We normally attempt to recruit distributors with established distribution channels and reputations for marketing and installing document imaging, data capture and workflow systems to market our products. We cannot assure you that we will be able to develop such relationships.

Our industry is marked by rapid technological changes and frequent new or updated product introductions, and if we do not respond to such rapid technological changes, new product introductions and enhancements and evolving industry standards, our products and services could become obsolete.

As processing speeds increase, memory capacities expand, software is upgraded, and mobile and onsite infrastructure improve, we need to ensure that our products, capitalize on these developments, and remain compatible with industry standards. Our ability to compete will depend upon our ability to offer state-of-the-art products generally, and cloud solutions in particular in a timely and cost-effective manner. Our product decisions must anticipate the changing demand for products. In 2016 we announced the release of our AP for SAP product and in 2017 we announced the release of our AP Cloud product. We can provide no assurance that these products will be successful or that our efforts to expand our customer base will succeed. If we are unable to develop, modify and enhance our existing technology to respond to such changing standards and customer demands, our business could be adversely affected. In addition, the development of new technologies, new product introductions or enhancements by our competitors could adversely affect our sales.

5

We have a history of quarterly fluctuations in our results of operations and expect these fluctuations to continue, this may cause our stock price to decline.

We have experienced and expect to experience in the future significant fluctuations in our quarterly results of operations.

Our lengthy sales cycle increases our exposure to customer cancellations or delays in orders, which may result in volatile quarterly revenues. Given the high average selling price of, and the cost and time required to implement our solutions, a customer's decision to license our products typically involves a significant commitment of resources and is influenced by the customer's budget cycles and internal approval procedures for information technology purchases. In addition, selling our solutions requires us to educate potential customers about our solutions' uses and benefits. As a result, our solutions have a long sales cycle, which can take 9 to 15 months or more. Consequently, we have difficulty predicting the quarter in which sales to expected customers may occur and actual sales may not necessarily be in the same calendar quarter or even year in which we expended resources in connection with marketing to the client. The sale of our solutions is also subject to delays from the lengthy budgeting, approval and competitive evaluation processes of our customers, which typically accompany significant capital expenditures.

Other factors that may contribute to fluctuations in our quarterly results of operations include:

- the size and timing of orders;
- customer deferral of orders in anticipation of new products, product upgrades or price enhancements;
- customer deferral of orders due to general economic conditions or a customer's specific cash flow shortages;
- the high level of competition that we encounter; and
- the timing of our product introductions, upgrades or enhancements or those of our competitors or of providers of complementary products.

Fluctuations in our quarterly results could discourage investors and cause the market price of our ordinary shares to decline.

Loss of large customers could adversely affect us.

In 2017 one customer accounted for more than 10% of our revenues. Loss of this customer would have a material adverse effect on the Company. We are actively recruiting additional large customers and partners for our products. If we become dependent on one or more large customers our, business, prospects, financial conditions and results of operations could be adversely affected by the loss of such customers.

Our success depends on our proprietary software technology.

Our success depends upon our proprietary software technology. Although we believe that our technology has been developed independently and does not infringe on the proprietary rights of others, we cannot assure you that the technology does not and will not infringe or that third parties will not assert infringement claims against us in the future. In the case of infringement, we would, under certain circumstances, be required to modify our products or obtain a license. We cannot assure you that we would be able to do so either in a timely manner under acceptable terms and conditions or at all, or that we will have the financial or other resources necessary to defend successfully a patent infringement or other proprietary rights infringement action. Further, even if we were not infringing, intellectual property litigation is expensive and time consuming for management. Any of the foregoing could have a material adverse effect on us. Furthermore, if our products or technologies are deemed to infringe upon the rights of

others, or if infringement claims are asserted against third parties whom we are obligated to indemnify, we could become liable for damages, which could have a material adverse effect on us.

6

Our products contain third party intellectual property which may expose us to additional risks.

We license components of our software systems and technology from third parties in reliance on such parties' representations as to ownership of the licensed intellectual property. If our licensors are found not to own or have rights to sublicense such rights to us and we are unable to replace the licensed technology with a comparable substitute, there could be a material adverse effect on our business prospects and financial results. Even if we were to replace licensed technology with available alternatives, it could take time to identify the best replacement and integrate it into our software. The delay and uncertainty could negatively impact our financial results. Furthermore, we could be sued for, or found liable for infringement arising from our use of such licensed technology and indemnity obligations, if any, on the part of the providers of such licensed technology might not be sufficient to cover liabilities we incur.

We use certain "open source" software tools that may be subject to intellectual property infringement claims, the assertion of which could impair our product development plans, interfere with our ability to support our clients or require us to pay licensing fees.

Certain of our products contain open source code, and we may use more open source code in the future. Open source code is code that is covered by a license agreement that permits the user to liberally copy, modify and distribute the software without cost, provided that users and modifiers abide by certain licensing requirements. The original developers of the open source code provide no warranties on such code. As a result of our use of open source software, we could be subject to suits by parties claiming ownership of what we believe to be open source code, and we may incur expenses in defending claims that we did not abide by the open source code license. If we are not successful in defending against such claims, we may be subject to monetary damages or be required to remove the open source code from our products. Such events could disrupt our operations and the sales of our products, which would negatively impact our revenues and cash flow. We monitor our use of such open source code to avoid subjecting our products to conditions that we do not intend. The use of such open source code, however, may ultimately subject some of our products to unintended conditions so that we are required to take remedial action that may divert resources away from our development efforts.

Our inability to protect our intellectual property could adversely affect our competitive position and, consequently, our business and operations.

Our success depends on our ability to protect our intellectual property. We rely upon trade secret protection, employee and third-party nondisclosure agreements and other intellectual property protection methods to protect our confidential and proprietary information. Despite these efforts, we cannot be certain that others will not otherwise gain access to our trade secrets or copy and use information that we regard as proprietary without our authorization. In the past, we have not obtained any patents. As a result of a change in our intellectual property protection policy, we have begun to file patent applications with regard to relevant technology. We have applications at this point for patents in the U.S. with regard to mobile capture, full page images and contextual classification. We may file additional patent applications in the future. We cannot assure you that:

- any of our existing patent applications will be accepted;
- we will be successful in generating technology in the future which will be susceptible to applications for patents;

any patents which we may obtain will be broad enough to protect our technology, will provide us with competitive advantages or will escape challenge or invalidation by third parties;

·the patents of others will not have an adverse effect on our ability to do business; or

·others will not independently develop similar products, duplicate our products or, if patents are issued to us, design around these patents.

Further, the laws of foreign jurisdictions where we sell and seek to sell our products may afford little or no protection of our intellectual property rights. We cannot assure you that the protection provided to our intellectual property rights by the laws and courts of foreign nations will be substantially similar to the remedies available under U.S. law.

Our products may contain defects, damaging our reputation, causing a loss of customers, requiring us to allocate significant time and financial resources to correct, and potentially resulting in liability claims.

Our products may contain undetected errors or defects, particularly when first introduced or when new versions or enhancements are released. In the past, we have discovered minor software bugs in certain products after they were released to the market. Such errors or defects could require us to divert financial and other resources to correct the problems.

In addition, our products are combined with complex products developed by other vendors. As a result, should problems occur, it may be difficult to identify the source or sources of the problems. Defects and errors, or end-user perception of defects and errors, found in current versions, new versions or enhancements of these products after commencement of commercial shipments may result in:

·damage to brand reputation;

·loss of customers;

·delay in market acceptance of current and future products;

·diversion of development and engineering resources to correct defects or errors; and

·warranty or product liability claims.

Although we have product liability insurance, defects, errors or successful product liability claims against us could have a material adverse effect on our business, prospects and financial results.

We engage in international sales, which expose us to a number of foreign political and economic risks.

We have significant operations in foreign countries, including research and development, sales and customer support operations. Currently, in addition to our operations in Israel, we have significant operations in the U.S., Germany, the United Kingdom, Australia and Singapore. Our international sales and other operations are subject to risks inherent in doing business in foreign countries, including, but not limited to:

·changing domestic and foreign customs and tariffs or other trade barriers;

·potential staffing difficulties and labor disputes;

- managing and obtaining support and distribution for local operations;
- difficulty in enforcing agreements through the different legal systems of the countries in which we operate;
- customers in the various countries in which we operate may have long payment cycles;
- seasonal reductions in business activity in certain parts of the world;
- restrictions on our ability to repatriate earnings from countries in which we operate;
- credit risk and financial conditions of local customers and distributors;
- potential difficulties in protecting intellectual property;
- potential imposition of restrictions on investments;
- potentially adverse tax consequences;
- foreign currency exchange restrictions and fluctuations;
- natural disasters; and

local political and social conditions, including the possibility of hyperinflationary conditions, terrorism and political instability in certain countries.

In 2015, 2016, and 2017 approximately 42%, 32%, and 32%, respectively, of our revenues were generated from sales made in the European Union. If this trend continues, we may be more particularly exposed to the risk of losing business and revenues as a result of trade restrictions imposed by the European Union as well as ramifications of the debt crisis in certain European countries. See “Volatility in the European Union and questions about its future may negatively affect our European operations.”.

We may not be successful in developing and implementing policies and strategies to address the foregoing risks in a timely and effective manner at each location where we do business. Consequently, the occurrence of one or more of the foregoing factors could have a material adverse effect on our international operations or upon our financial condition and results of operations.

We may be adversely impacted by fluctuations in currency exchange rates.

We maintain operations and generate revenues in a number of countries. The results of operations and the financial position of our local operations are generally reported in the relevant local currencies and then translated into U.S. dollars at the applicable exchange rates for inclusion in our consolidated financial statements, exposing us to currency translation risk. In addition, we are exposed to currency transaction risk because some of our expenses are incurred in a different currency from the currency in which our revenues are received and from which our revenues and expenses are reported. Our most significant currency exposures are to the Euro, New Israeli Shekel, British Pound, Singapore dollar, Australian dollar, Japanese Yen and Brazilian Real. In periods when the U.S. dollar strengthens against these currencies our revenue may be adversely impacted. In periods when the U.S. dollar weakens against these currencies, our expenses may be adversely affected. Brexit-related has led to currency volatility, particularly with respect to the British Pound and the Euro and could have a negative impact on our results. Although from time to time we may purchase forward exchange contracts to reduce currency transaction risk, these purchases, if made, will not eliminate translation risk or all currency risk.

Political, economic and military conditions in Israel may adversely affect our ability to develop, manufacture and market our products.

Because our principal offices are located in Israel, political, economic and military conditions in Israel directly affect our 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. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. There has been a marked increase in such hostility and a significant deterioration of Israel's relationship with the Palestinian Authority since October 2000 and the peace process is currently at a standstill. Since 2011 there has been increasing instability in neighboring Arab countries including Syria, Egypt, Jordan, Tunisia, Libya, Bahrain, and Yemen culminating in the replacement of certain leaders in some of those countries and the control of territories by extremist Islamic groups. In addition, there is a high level of tension relating to Iran's nuclear capabilities, Iran's threats to attack Israel, Iran's military presence in Syria, and the potential response of Israel and the international community to Iran's gaining nuclear capabilities. Civil war in Syria has intensified and has become increasingly complex over recent months resulting in volatile developments in the region. Stray rounds from the conflict have landed in Israel from time to time and there have been cross-border skirmishes which increase the risk of escalation.

In December 2017 the United States announced a plan to move the United States embassy in Israel from Tel Aviv to Jerusalem drawing criticism from Arab and European leaders and spurring protests in Israel. Jerusalem is one of the world's most fiercely contested areas as it is claimed by both Palestinians and Israelis. The United States moving its embassy may have an impact in efforts to create peace between Israel and Palestinians.

Continuing or escalating instabilities and hostilities in the region or curtailment of trade between Israel and its present trading partners as a result or in response to such instabilities may have an adverse effect on our business conditions, including our ability to develop, manufacture and market our products.

Rising political tensions and negative publicity about Israel may negatively impact demand for our products.

Our principal offices are located in Ramat Gan, Israel. A number of groups in several countries have called for consumer boycotts of Israeli products. While many of those boycotts are focused on products originating in the West Bank and Ramat Gan is not in that area, other boycotts do not differentiate between different areas under Israeli control. Various political events from time to time have led to the revival or intensification of boycott efforts. Existing or future boycott efforts might adversely affect our sales efforts, and could have a material adverse effect on our business, prospects, financial condition and results of operations. Israel's ongoing military conflict with Hamas and the resulting invasion of parts of the Gaza Strip was met with new international efforts to boycott Israeli products and services. While it is unclear as whether such efforts will have a material impact on Israeli business, it remains possible that they could discourage current and potential customers from purchasing our products and thereby have a negative impact on our business, prospects and financial condition.

Our operations may be disrupted by the obligation of key personnel to perform military service.

Generally, all male adult citizens and permanent residents of Israel under the age of 42 (or older, for citizens who hold certain positions in the Israeli armed forces reserves) are obligated, unless exempt, to perform military reserve duty annually and some of our employees in Israel are so obligated. Moreover, in the event of armed conflict in which Israel is involved or the threat of such conflict, these employees might be called for active military duty for an unlimited period of time. Increased military activity could also result in a reduction of prospective qualified employees available to work for us to expand our business or replace employees on active military duty.

Our operations could be disrupted by the absence for a significant period of key employees as a result of military service. Any disruption in our operations could adversely affect our ability to develop and market products.

We may not be able to expand our personnel or marketing efforts quickly enough to support our growth.

Because of our small size and our business strategy to increase our sales we anticipate an increased demand on all of our resources. To the extent that our efforts to generate new business and increase demand for our products and services are successful, we will need to accurately estimate our need for personnel or marketing and customer support, or we may not be able to support our future growth. We cannot assure you that we will be able to provide such services on adequate terms and conditions or at all. Furthermore, in order to remain competitive and keep our products up to date, we need to continue to attract and retain a qualified team of employees. If we fail to obtain the human resources our business requires, there could be a material adverse effect on our business, prospects, financial conditions and results of operations.

Additional acquisitions may lead to increased expenditures and integration costs, and could strain management, financial, and operational resources.

In the past, we acquired related complementary businesses in an effort to expand capacity, enter new markets and diversify our sources of revenue. Those acquisitions strained our management, financial and operational resources.

Any future acquisition may also generate such strain. In the event we engage in additional acquisitions, they may also result in potentially dilutive issuances of equity securities, incurrence of additional debt, the assumption of known and unknown liabilities, the amortization of expenses related to intangible assets and the impairment of goodwill, all of which could harm our business, financial condition and operating results.

We currently have subsidiaries in foreign countries and additional acquisitions in foreign countries, should we choose to pursue them, may pose additional challenges. We could experience inefficiencies in conducting our business as we integrate new operations and manage geographically dispersed operations. Also, the acquired businesses may not yield the income and levels of activity we expected them to yield, which may result in losses.

Additionally, we may not succeed in retaining or hiring qualified management, sales, customer support, and technical personnel to integrate acquired operations, manage future growth effectively, and accomplish our overall objectives. Competition for qualified personnel is intense. If we expand too fast, or fail to integrate our recently acquired businesses or other new businesses, or lose key personnel from our recently acquired businesses or other businesses, there could be a material adverse effect on our business, prospects, financial condition and results of operations.

Government grants similar to grants we have received for research and development expenditures in the past may not be available to us in the future. Furthermore, our receipt of such grants limits our ability to develop products and transfer technologies outside of Israel and imposes certain liabilities on us.

We have received grants on a number of occasions from the National Technological Innovation Authority (the "NTIA") of the government of Israel NTIA under the Law for the Encouragement of Research, Development and Technological Development in Industry, 1984. (Until the NTIA was created in an amendment to that law in 2015, such grants were made and administered by the Office of the Chief Scientist of the Ministry of the Economy. We will refer use "NTIA" with regard to all such grants, even if they pre-date the amendment.) Such grants were given to finance a portion of our research and development expenditures in Israel. Such grants generally bear royalties on sales of products utilizing technologies developed using such grants or arising out of such technologies up to a maximum of 100% of the amount of the grant, linked to the dollar, plus interest at the LIBOR rate. The grants received during 2012 through 2017 totaled \$0.7 million. During 2016 and 2017 we received grants from the NTIA totaling \$0.24 and \$0.02 million, respectively. The Israeli government may decide not to continue the program in the future at its current level

or to terminate it altogether or the NTIA may not accede to future grant requests from us. In addition, if we fail to comply with any of the conditions imposed by the NTIA, including the payment of royalties with respect to grants received, we may be required to refund any payments previously received from the NTIA, together with interest and penalties. The terms of the NTIA grants limit our ability to transfer technologies outside of Israel without the prior approval of the NTIA, if such technologies were developed using NTIA grants or arose out of such technologies. The NTIA has the right, but not the obligation, to allow transfer of technology outside of Israel. Even if we receive approval for the transfer of technology outside of Israel, such approval of the NTIA may not be obtained on terms that are acceptable to us, or at all.

If we fail to satisfy the conditions specified under Israeli law, we may be denied benefits to which we are currently entitled or may be entitled to in the future.

Our activities in Israel have been granted "Approved Enterprise" (established plan) and "Benefited Enterprise" status under "The Law for the Encouragement of Capital Investments, 1959", or the Investment Law, as amended. The benefits available to an Approved Enterprise program or a Benefited Enterprise are normally in the form of favorable tax rates and are dependent upon the continuing fulfillment of ongoing conditions stipulated in the certificate of approval or under applicable law. If we fail to comply with these conditions, in whole or in part, benefits from tax exemptions or reduced tax rates would likely be denied us in the future and we could be required to refund tax benefits already received. There can be no assurance that such benefits will be continued in the future at their current levels or at any level.

For a description of the investment law and its recent material amendments, see "Additional Information-Law for the Encouragement of Capital Investments, 1959."

The amendment of Israeli tax laws or tax laws of other countries may adversely affect our profitability.

Our tax expenses and the resulting effective tax rate reflected in our financial statements may increase over time as a result of changes in corporate income tax rates, other changes in the tax laws of the countries in which we operate or changes in the mix of countries where we generate profit. These changes could have a material adverse effect on our business, competitiveness and financial results.

The application and/or amendment of Israeli laws or laws of other countries may adversely affect our ability to enforce judgments or other rights.

Because our principal offices are located in Israel, we are subject to Israeli law. Many of our contracts with third parties are subject to the laws of other jurisdictions. We cannot assure you that any judgments granted in the U.S. or any jurisdiction other than Israel would be capable of enforcement or execution in Israel. Nor can we assure you that any of our contracts pursuant to the laws of any foreign country are enforceable by us. The inability to enforce or execute judgments or other rights and/or the possibility of the laws of various jurisdictions being amended from time to time may have a material adverse effect on our business, prospects, and financial condition.

It may be difficult to enforce a U.S. judgment against us, our officers and directors, assert U.S. securities law claims in Israel or serve process on substantially all of our officers and directors.

We are incorporated in Israel. Some of our executive officers and directors are nonresidents of the U.S., and a majority of our assets and the assets of these persons are located outside the U.S. Therefore, it may be difficult to enforce a judgment obtained in the U.S. against us or any such persons or to effect service of process upon these persons in the U.S. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws if they conclude Israel is not the most appropriate forum to bring such a claim. In addition, even if an Israeli court would agree to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved as a fact which can be a time-consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel addressing these matters. Additionally, there is doubt as to the enforceability of civil liabilities under the Securities Act and the Exchange Act in original actions instituted in Israel.

Under current Israeli law, we may not be able to enforce covenants not to compete, and, therefore, we may be unable to prevent competitors from benefiting from the expertise of some of our former employees.

In general, we have entered into non-competition agreements with our employees in Israel. These agreements prohibit our employees, if they cease working for us, from competing directly with us or working for our competitors for a limited period. Under current law, it is unlikely that we will be unable to enforce these agreements, and it may be difficult for us to restrict our competitors from gaining the expertise that our former employees gained while working for us.

Risks Related to Our Ordinary Shares

Our Ordinary Shares have been subject to frequent significant price fluctuations.

Trading in shares of companies listed on the NASDAQ in general and trading in shares of technology companies in particular have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to operating performance. These broad market and industry fluctuations may depress our share price, regardless of our actual operating results.

In addition, the trading price of our ordinary shares has been highly volatile and could continue to be subject to wide fluctuations in price in response to various factors, many of which are beyond our control, including, but not limited to:

- actual or anticipated period-to-period fluctuations in financial results;
- litigation or the threat of litigation;
- failure to achieve, or changes in, financial estimates by securities analysts, if any;
- announcements regarding new or existing products or services or technological innovations by us or our competitors;
- conditions or trends in the software industry;
- additions or departures of key personnel or directors;
- regulatory developments in the U.S. and other countries in which we operate;
- developments or disputes concerning our intellectual property rights;
- general market conditions;
- overall fluctuations in the U.S. and world equity markets; and
- economic and other external factors or disasters or crises.

If we fail to maintain NASDAQ minimum price requirements or other applicable continued listing requirements, our ordinary shares could be delisted.

According to NASDAQ listing standards, if the stock price of a listed company falls below \$1.00 a share for a period of 30 consecutive business days, such company's stock may be subject to delisting unless such failure is cured within 180 days from the date on which NASDAQ notifies the listed company of such failure. There were periods in 2009, 2010 and 2017 during which our stock price fell below \$1.00 per share.

If we fail to maintain the minimum price for our ordinary shares required by NASDAQ or comply with other continued listing requirements of NASDAQ, our ordinary shares could be involuntarily delisted.

A large number of our ordinary shares could be sold in the market in the near future, which would cause downward pressure on the market price for our ordinary shares.

As of March 31, 2018, we had approximately 18,251,722 ordinary shares outstanding, of which 14,127,114 were held by shareholders who were not our directors, executive officers and more than 10% shareholders. A substantial portion of our shares is currently freely trading without restriction under the Securities Act of 1933, as amended, or the Securities Act, having been registered for resale or held by their holders for over one year and are eligible for sale under Rule 144. As of March 31, 2018, there were outstanding options to purchase an aggregate of approximately 2,612,265 ordinary shares. In addition, there were 407,725 outstanding RSUs.

In May 2018, we entered into the Term Sheet. In connection with the Credit Facility we will issue 10-year warrants to purchase the number of our ordinary shares equal to 40% of the total Credit Facility divided by the market price. The warrants will have an exercise price equal to the market price of the ordinary shares plus 15%.

In December 2016, we borrowed \$5 million in exchange for the Convertible Note, which bears interest at the prime rate plus 2.5% (if paid in cash) or 3% (if the interest capitalized) per annum and matures (if not converted prior) in December 2020. As of March 31, 2018, the principal amount of the Convertible Note is convertible into 3,094,998 of our ordinary shares.

Upon withdrawal from the Credit Facility, the Convertible Note, plus accrued interest, will be exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0%.

The Company has not yet determined if it will draw on the Credit Facility. The issuance of the warrants and the changes to the Convertible Note are conditioned upon the drawing down of the Credit Facility.

The issuance of and resale of our ordinary shares that may be issued to HCP FVE on conversion of the Convertible Note or exercise of the Warrants could have a negative impact on the price of our ordinary shares.

Future issuances of our ordinary shares could adversely affect the trading price of our ordinary shares and could result in substantial dilution to shareholders.

In May 2018, we entered into the Term Sheet. In connection with the Credit Facility we will issue 10-year warrants to purchase the number of our ordinary shares equal to 40% of the total Credit Facility divided by the market price. The warrants will have an exercise price equal to the market price of the ordinary shares plus 15%.

In December 2016, we borrowed \$5 million in exchange for the Convertible Note, which bears interest at the prime rate plus 2.5% (if paid in cash) or 3% (if the interest capitalized) per annum and matures (if not converted prior) in December 2020. As of March 31, 2018, the principal amount of the Convertible Note is convertible into 3,094,998 of our ordinary shares. Upon withdrawal from the Credit Facility, the Convertible Note, plus accrued interest, will be

exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0%.

The Company has not yet determined if it will draw on the Credit Facility. The issuance of the warrants and the changes to the Convertible Note are conditioned upon the drawing down of the Credit Facility.

In addition, we may need to issue substantial amounts of our ordinary shares in financings or acquisitions in the future. To the extent that the market price of our ordinary shares declines, we will need to issue an increasing number of ordinary shares per dollar of equity investment. In order to obtain future financing if required, it is likely that we will issue additional ordinary shares or financial instruments that are exchangeable for or convertible into ordinary shares. Capital raising activities, if available, and dilution associated with such activities could cause our share price to decline.

Also, in order to compensate our directors, provide incentives to our employees and induce prospective employees and consultants to work for us, from time to time we offer and issue options to purchase ordinary shares and/or rights exchangeable for or convertible into ordinary shares. The company has also recently adopted an incentive plan by which certain members of management may elect to receive all or part of their annual bonuses earned upon meeting preset professional targets in the form of restricted stock units ("RSUs") rather than cash. Future issuances of shares or RSUs could result in substantial dilution to shareholders.

Our ordinary shares may become subject to the SEC's penny stock rules.

Generally, transactions in securities that are traded in the U.S. at a market price per share of less than \$5.00, may be subject to the "penny stock" rules promulgated under the Exchange Act. Under these rules, broker-dealers who recommend such securities to persons other than institutional investors:

- must make a special written suitability determination for the purchaser;
- receive the purchaser's written agreement to a transaction prior to sale;
- provide the purchaser with risk disclosure documents which identify risks associated with investing in "penny stocks" and which describe the market for these "penny stocks" as well as a purchaser's legal remedies; and
- obtain a signed and dated acknowledgment from the purchaser demonstrating that the purchaser has actually received the required risk disclosure document before a transaction in a "penny stock" can be completed.

As a result of these requirements, if our ordinary shares become subject to the "penny stock" rules, broker-dealers may find it difficult to effectuate customer transactions and trading activity in our ordinary shares in the U.S. may be significantly limited. Some broker-dealers have adopted a policy under which they refuse to allow clients to hold penny stocks in their brokerage accounts, or refuse to open new accounts holding penny stocks. Accordingly, the market price of our ordinary shares may be depressed or limited, and investors may find it more difficult to sell the shares.

We have not paid dividends in the past.

We have never declared or paid any cash dividends on our ordinary shares. We have retained any future earnings to finance operations and to expand our business and, therefore, may not pay any cash dividends on ordinary shares in the future.

The rights and responsibilities of our shareholders are 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 articles of association and by the Israeli Companies Law, 5759-1999, or the Companies Law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, pursuant to the Companies Law each shareholder of an Israeli company has to act in good faith in exercising its rights and fulfilling its obligations toward the company and other shareholders and to refrain from abusing its power in the company, including, among other things, in voting at the general meeting of shareholders and class meetings, on amendments to a company's articles of association, increases in a company's authorized share capital, mergers, and transactions requiring shareholders' approval under the Companies Law. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that it possesses the power to determine the outcome of a shareholder vote or who has the power to appoint or prevent the appointment of a director or officer in the company, or has other powers toward the company has a duty of fairness toward the company. However, the

Companies Law does not define the substance of this duty of fairness, which is determined primarily in case law.

15

As a foreign private issuer whose shares are listed on NASDAQ, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements.

As a foreign private issuer whose shares are listed on NASDAQ, we are permitted to follow certain home country corporate governance practices instead of certain requirements of The NASDAQ Listing Rules. As a foreign private issuer listed on NASDAQ, we may also follow home country practice with regard to, among other things, composition of the Board of Directors and quorum at shareholders' meetings. A foreign private issuer that elects to follow a home country practice instead of NASDAQ requirements 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 addition, a foreign private issuer must disclose in its annual reports filed with the Securities and Exchange Commission each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement. Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ's corporate governance rules.

Provisions of Israeli law could delay, prevent or make difficult a change of control and therefore depress the price of our shares.

The Companies Law generally provides that a merger be approved by the Board of Directors and by the shareholders of a participating company by the vote of a majority of the shares of each class present and voting on the proposed merger. The Companies Law has specific provisions for determining the majority of the shareholder vote. Upon the request of any creditor of a constituent in the proposed merger, a court may delay or prevent the merger if it concludes that there is a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy its obligations to creditors. In general, a merger may not be completed until the passage of certain statutory time periods. In addition, another procedure for completing an acquisition or merger requires court approval of the terms of the transaction. In certain circumstances, an acquisition of shares in a public company must be made by means of a tender offer that complies with certain requirements of the Companies Law that differ from those that apply to U.S. corporations. Furthermore, Israeli tax considerations may make potential acquisitions unappealing to us or to some of our shareholders. Israeli tax law treats some acquisitions, such as stock-for-stock exchanges between an Israeli company and a foreign company, less favorably than U.S. tax laws. These provisions of Israeli corporate and tax law may have the effect of delaying, preventing or making more difficult an acquisition of or merger with us, which, if public trading in our ordinary shares resumes, could depress our share price.

We are a foreign private issuer and you will receive less information about us than you would from a domestic U.S. corporation.

As a "foreign private issuer", we are exempt from rules under the Exchange Act that impose certain disclosure and procedural requirements in connection with proxy solicitations under Section 14 of the Exchange Act. Our directors, executive officers and principal shareholders also are exempt from the reporting and "short-swing" profit recovery provisions of Section 16 of the Exchange Act and the rules thereunder with respect to their purchases and sales of our shares. In addition, we are not required to file periodic reports and financial statements with the SEC as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act. As a result, you may not be able to obtain the same information relating to us as you would for a domestic U.S. corporation.

Due to an exemption available to us as a foreign private issuer, our interim financial information is not audited or reviewed.

As a "foreign private issuer", we are exempt from rules under the Exchange Act that require quarterly financial statements since our home jurisdiction does not require such disclosure. While we provide interim financial information through Forms 6-K in accordance with NASDAQ requirements, such financial information is not audited or subject to the heightened level of review required of domestic issuers. As a result, you may not be able to obtain the same information relating to us as you would for a domestic U.S. corporation.

Our compliance and reporting costs will increase at such time that we are no longer a foreign private issuer.

We are required to annually determine whether we continue to qualify as foreign private issuer. Although our most recent annual determination applicable to the period covered by this report concluded that we were a foreign private issuer, we believe that prospectively, our status may change. In particular, due to changes in our board of directors and our latest assessment of the percentage of our securities held by U.S. persons, we believe that at the time of our next determination of status, we may not qualify as a foreign private issuer. If that occurs, we would be subject to the more detailed filing requirements of the United States Securities Exchange Act of 1934 as they apply to domestic U.S. companies. As a result, we would be required to file current reports on form 8-K, quarterly reports on Form 10-Q, and annual reports on Form 10-K, and be subject to additional accounting and reporting requirements. We anticipate that the increased compliance will significantly increase our legal and accounting costs and could negatively affect our business, prospects, and financial condition.

Although our internal control over financial reporting was considered effective as of December 31, 2017, there is no assurance that our internal control over financial reporting will continue to be effective in the future, which could result in our financial statements being unreliable, government investigation or loss of investor confidence in our financial reports.

If we fail to maintain the adequacy of our internal controls, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting. We may also identify material weaknesses or significant deficiencies in our internal control over financial reporting. In addition, our internal control over financial reporting has not been audited by our independent registered public accounting firm. In the future, if we are unable to assert that our internal controls are effective; our investors could lose confidence in the accuracy and completeness of our financial reports, which in turn could cause our stock price to decline. Failure to maintain effective internal control over financial reporting could also result in investigation or sanctions by regulatory authorities.

ITEM 4. INFORMATION ABOUT THE COMPANY

HISTORY AND DEVELOPMENT

Establishment, Legal Name, Office and Trading Markets

We were incorporated in March of 1991, are domiciled in Israel and exist as a company with limited share liability subject to Israeli law. Our legal name is Top Image Systems Ltd. and our registered and principal executive offices are located in Israel at 2 Ben Gurion St, Ramat Gan, 5257334, and our telephone number is + 972-3-767-9100. Our website is <http://www.topimagesystems.com> (the information contained in our website is not a part of this annual report and no portion of such information is incorporated herein).

Our ordinary shares began trading on the NASDAQ in November 1996. Our ordinary shares were previously also traded on the Tel Aviv Stock Exchange (“TASE”). Effective October 31, 2014, we voluntarily delisted our ordinary shares from the TASE.

Recent Developments

Credit Facility with Hale Capital Partners

In May 2018, in order to provide the Company with additional liquidity if needed, we entered into the Term Sheet with Hale Capital Partners which provides for a new senior secured term loan of up to \$3 million as part of the secured Credit Facility that would include the existing Convertible Note held by an affiliate of Hale in an amount of \$5.6 million. The Senior Loan would include monthly repayments of \$50,000 in 2019 and \$100,000 from January 2020 through maturity (such amount to increase on the happening of certain events), an interest rate of Prime plus 5% payable monthly and a 36-month term. In connection with the Credit Facility we will issue 10-year warrants to purchase the number of our ordinary shares equal to 40% of the total Credit Facility divided by the market price. The warrants will have an exercise price equal to the market price of the ordinary shares plus 15%. The Credit Facility will be secured by the Company’s assets and will be guaranteed by each of our subsidiaries, subject to certain limitations. The Senior Loan would be required to be prepaid on certain events and would be prepayable at the Company’s option at a premium beginning one year following closing.

Upon withdrawal from the Credit Facility, the Convertible Note, plus accrued interest, will be exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0% and the convertibility to convertible preferred shares will be cancelled.

The Company has not yet determined if it will draw on the Credit Facility. The issuance of the warrants and the changes to the Convertible Note are conditioned upon the drawing down of the Credit Facility. If the Company elects not to withdraw funds out of the Credit Facility, it will be obligated to pay to Hale Capital Partners, LP a break up fee of equal to three percent (3%) of the Credit Facility.

Appointment of Don Dixon as Chairman of the Board

Effective January 1, 2017 Mr. Don Dixon has assumed the position of Chairman of the Company's Board of Directors; Mr. Izhak Nakar, Company Founder, stepped down from his position as Active Chairman as of the same day. Mr. Nakar remains a member of the Company's Board of Directors and is still a significant shareholder of the Company. Until June 30, 2017 Mr. Nakar continued to provide some of the services to the Company in his role as Active Chairman.

Mr. Dixon is a Managing Director of Trident Capital, a major shareholder in Top Image Systems, and has extensive experience in transforming and growing shareholder value for the companies under his management. He brings his expertise, experience and global network of business contacts to the Company. In the past, Mr. Dixon has led companies which have become industry leaders, including Qualys, Merchant e-Solutions, Bytemobile, CSG Systems, and eGistics, Inc., which was acquired by the Company in 2014. Over the course of his career, Mr. Dixon has been involved in successful exits from 36 companies. He has been a member of various boards of directors, including Affiliated Computer Systems which was later sold to Xerox. Mr. Dixon is also Co-Chairman of the Advisory Committee of the Princeton University School of Engineering and Applied Sciences and serves on the Advisory Board of the Harvard Kennedy School Center for Public Leadership.

Appointment of Brendan Reidy to Chief Executive Officer

Effective, August 31, 2016 Brendan Reidy assumed the position of Chief Executive Officer of the Company. Mr. Reidy is a seasoned executive with a proven track record of driving rapid growth and increased shareholders' value within the software as a service ("SaaS") industry. Mr. Reidy most recently served as President, Chief Operating Officer and Chief Technology Officer of XRS Corporation. Under Mr. Reidy's leadership, XRS achieved a nearly twelfold increase in valuation leading to the sale of XRS at a premium. In parallel, Mr. Reidy served as a member of the board of directors of eGistics for ten years prior to our acquisition of the company. Previously Mr. Reidy was Chairman, President and CEO of Clarus Systems, Inc. In addition, Mr. Reidy also served as a Venture Partner at Trident Capital, and at various times served on the boards of four Trident portfolio companies and held two full-time positions with portfolio companies. He earned an M.B.A. from The Wharton School, University of Pennsylvania, and a B.A. from Stanford University.

Consolidation of Operations

During fiscal 2017, TIS announced and implemented additional measures to achieve cost reductions through consolidation and restructuring:

Consolidation of sales and marketing functions for the Americas into our US headquarters in Plano, Texas, under the leadership of John McCaffrey, Vice President and General Manager of TIS Americas. John brings to TIS a wealth of experience and proven track record in building high performance organizations, delivering sustained top-line revenue growth and shareholder value. He has consistently delivered results in senior leadership roles including as Advisory Consulting / Professional Services, Enterprise Sales, Marketing, Major Account Management and Strategic Partnerships. John was led the professional service team at Virtustream prior to its \$1.2B acquisition by EMC in 2015. In addition, John served on the leadership team of Clarus Systems (sold to OPNET, now Riverbed) and Adjoined Consulting (sold to Kanbay, now Capgemini). Mr. McCaffrey started his career in the telecom industry at US WEST (now CenturyLink). He holds an M.S. from the MIT Sloan School of Management, an M.A. from Boston University and a B.S. in Engineering from Princeton University. He also serves as a U.S. Air Force veteran, having attained the rank of Captain.

Integration of the global Engineering teams under Arvind Sharma, Senior Vice President of Engineering. Arvind brings over 25 years of experience in the software industry, developing products in various fields such as mobile technologies, cloud solutions, and cybersecurity. He has led cross-functional teams to success by implementing new processes, innovative automation techniques and Agile/SCRUM methodologies. With in-depth knowledge of cyber security, Arvind's expertise includes compliance, regulations, data breaches and protection strategies. Arvind's past experience includes working at companies such as AT&T Bell Labs, Motorola and Yahoo!, as well as multiple startups in the San Francisco Bay Area. More recently, he led the engineering efforts for a cybersecurity firm and has managed global teams in the US, China, Canada, Mexico, India and Spain. Arvind brings to TIS his passion for building high-caliber engineering teams that develop platforms in Public/Private Cloud, SaaS Products, Big Data, Web APIs, Mobile and Web Applications. Arvind holds a degree in Physics and Computer Science from University of Bombay, India.

Appointment of Patti Barton as Acting Chief Financial Officer. Having joined Top Image Systems in 2015, Ms. Barton previously served as the Company's Vice President - Global Finance in our US headquarters. Ms. Barton has more than 30 years of experience with leading finance organizations at companies such as Pulte Homes, Fannie Mae and Inland Investments. She is a seasoned finance executive with broad experience in strategic management and finance, as well as in SEC reporting and risk management. Ms. Barton previously served eight years with KPMG and is a licensed CPA. Ms. Barton earned a B.B.A. from the University of Texas at Arlington College of Business.

Yossi Dagan, Chief Financial Officer, Kristian Niklasson, Chief Services Officer and Michael Schrader, President made decisions to pursue other opportunities. Brendan Reidy assumed responsibilities for EMEA

Operations and Professional Services. With the continuity of Brendan Reidy and Patti Barton, as well as the addition of Arvind Sharma and John McCaffrey, we experienced little operational impact during the transition of our management team.

Credit Facility with a U.S. Based Bank

In December 2017, we secured a \$2.5 million line of credit with a U.S. based bank. The line is secured by the accounts receivables of our U.S. subsidiary and bears interest at 2.5% or 3% (if in stream line mode) per annum and matures in December 2018. We had borrowings outstanding of 0.8 against the line of credit at December 31, 2017. Subsequent to December 31, 2017, the borrowings under the line were repaid and the line was cancelled

Sale of Convertible Note to HPE-FVE, LLC

In December 2016, we borrowed \$5 million from HCP-FVE, LLC, an affiliate of Hale Capital Partners in exchange for the Convertible Note which bears interest at the prime rate plus 2.5% (if paid in cash) or 3% (if the interest capitalized) per annum and matures (if not converted prior) in December 2020. As of March 31, 2018, the principal amount of the Convertible Note is convertible into 3,094,998 of our ordinary shares. The transaction contemplates revising our Articles of Association to create a new class of Company preferred stock. Our stockholders approved the revised Articles of Association during the annual shareholders meeting in October 2017. As of May 15, 2018, the Convertible Note has not been converted into preferred shares. If issued, the preferred shares will also be convertible into our ordinary shares at the same conversion price

Upon withdrawal from the Credit Facility, the Convertible Note, plus accrued interest, will be exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0% and the convertibility to convertible preferred shares will be cancelled.

The Convertible Note and preferred stock have certain approval rights and provide HCP FVE with the right to appoint a member to our Board of Directors. The approval rights remain in effect for as long as HCP FVE holds at least 35% of the original aggregate principle amount of the Convertible Note or its preferred stock equivalent, as the case may be. Such rights restrict the Company's ability to take certain actions, including, but not limited to: (i) liquidating or dissolving the Company or any subsidiary; (ii) issuing certain securities of the Company senior to those issued to HCP FVE or at a lower price than paid by HCP FVE; (iii) incurring certain indebtedness (including any that is convertible into capital stock of the Company); (iv) paying dividends or other distributions or redeeming any ordinary shares or other equity interests or any securities convertible into our ordinary shares; (v) increasing the number of shares available under our stock option plan, amending such plan, or adopting a new equity incentive plan; (vi) approving any cash incentive or retention plan for its officers and/or directors (unless required to be approved, and actually approved, by the Company's shareholders); (vii) incurring any lien on any of the Company's or any of its subsidiaries' respective properties or assets; or (viii) making any significant change in the nature of the Company's business.

We are entitled to force the conversion of the Convertible Note or preferred stock, as the case may be, if the ordinary shares trade at 250% of the conversion price for at least 45 consecutive trading days. HCP FVE will have the right to demand that the Convertible Note or the preferred stock, as the case may be, be redeemed after December 5, 2020. The proceeds from the sale will be used by the Company for general working capital purposes, including accelerating the company's ongoing migration of its innovative financial process automation solutions to a cloud-based platform.

Upon withdrawal from the Credit Facility, the Convertible Note, plus accrued interest, will be exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0% and the convertibility to convertible preferred shares will be cancelled.

HCP FVE is a private growth equity fund focused on partnering with talented management teams to achieve remarkable corporate transformations that benefit all stakeholders including employees, customers, and our investors. Hale is represented on the Top Image Systems Board.

BUSINESS ENVIRONMENT

While the overall business climate continues to improve with forecasted 2018 GDP growth of 4.0% there are signs of increased volatility driven by anticipated inflationary pressures given increased input costs and wage pressures.

In order to realize continuous efficiency gains and achieve business agility in an intensely competitive global economic climate businesses are planning to significantly accelerate spending on digital transformation (DX).

Worldwide spending on DX technologies (hardware, software, and services) is expected to be nearly \$1.3 trillion in 2018, an increase of 16.8% over the \$1.1 trillion spent in 2017. A new update to the Worldwide Semiannual Digital Transformation Spending Guide from International Data Corporation (IDC) forecasts DX spending to maintain a strong pace of growth over the 2016-2021 forecast period with a compound annual growth rate (CAGR) of 17.9%. By 2021, DX spending is expected nearly double to more than \$2.1 trillion.

Customer retention and customer loyalty are the primary drivers for accelerated investments in process management. Businesses seek solutions that help them flourish in the digital economy by accelerating customer onboarding, reducing customers' transaction costs, ensuring customer satisfaction and gaining better insight into customer behavior and sentiments to anticipate their future needs.

The introduction of advanced robotics automation technologies, big data analytics, and cloud deployment options are ushering in a new era of enterprise transformation. These technologies empower midsize companies to automate labor intensive and error prone business processes to mitigate risk, reduce transaction costs, and improve customer engagement and service levels.

AI has massive potential to enhance decision making, reinvent business models and ecosystems, and remake the customer experience. Many organizations have already taken notice of this, with a recent Gartner survey indicating that 59% of organizations are gathering information to build an AI strategy, while the rest are piloting or adopting AI programs.

AI has become a major battleground for software and service vendors, with AI expected to be incorporated into every application, app and service, at least on some level. Gartner highlights augmented analytics, which uses machine learning to automate data preparation, insight discovery and insight sharing as an area of growing strategic importance. Organizations should explore intelligent apps that augment human activity, and identify use cases across advanced analytics, intelligent processes and new user experiences

Digital business moments, which are a combination of business events that reflect the discovery of notable states or state changes, will drive digital business. While a simple example would be the signal that a purchase order has been

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completed, as the “Internet of Things” and other technologies emerge, complex events can be detected more quickly and analyzed in greater detail. Gartner suggests that enterprises should embrace “event thinking,” given that by 2020, event-sourced, real-time situational awareness will be a required characteristic for 80% of digital business solutions, and 80% of new business ecosystems will require support for event processing.

There have been significant advancements in machine learning technologies, commonly referred to as robotics process automation, designed to lower the costs of labor-intensive and error-prone business processes. These advancements make it easier to proactively comply with data security and privacy requirements.

With the proliferation of incoming information from multiple channels, it is imperative for organizations to invest in capabilities to capture information at the source, digitize it as soon as it enters the organization and transform that information into actionable business processes. This includes using intelligent classification tools to ensure that personally identifiable information is protected and managed. Notably, we believe that only a minority of organizations employ effective meta-data and classification of their data.

Recent developments have heightened both public focus and the commercial need for solutions with respect to the processing of personally identifiable information. In addition, on May 25, 2018, the General Data Protection Regulation will come into effect in the European Union and will introduce new privacy and compliance requirements concerning the collection of data and could potentially subject violators to heavy fines. The new rules regulate data concerning European persons even if it is collected and stored outside the European Union, and have further increased global attention to collection, protection, and storage procedures.

Accordingly, we believe there exists significant growth opportunity in solutions which reduce error-prone and labor-intensive tasks associated with the capture, extraction and classification of large volumes of information and accelerate the process of compliance with data classification, retention and compliance policies and regulations.

Reduced Transaction Costs

Organizations continue to face significant headwinds caused by sluggish global GDP growth and rising geo-political risks. Given such a climate of uncertainty, finding the right balance between growth and profitability is a daunting task. The Hackett Group Report found that, “due to the continuing economic uncertainty, budgets in the coming year will be strained, making it imperative to fund innovation and transformation through cost reductions made elsewhere.” (Source: “Key Issues 2016: Business Services Must Improve Agility to Balance Cost, Innovation, and Transformation”, The Hackett Group, 2016 by Erik Dorr and Sean Kracklauer)

In particular, corporate finance processes tend to be inefficient and remain, to a large extent, paper- intensive. For example, research shows that the accounts payable function remains a predominantly paper-intensive function. According to Ardent Partners, the average cost per invoice is \$15.96, while straight-through processing can reduce the average cost per invoice to \$2.94. ” (Source: “ePayables 2015: Higher Ground”, Ardent Partners, 2015, Andrew Bartolini and Christopher Dwyer) A recent PWC report found that, “although finance will always require significant investment, the fact that top quartile costs are 40% lower than average performers indicates that some organizations have been able to better manage finance costs through a variety of methods, including automation, shared services and more efficient use of capacity.” (Source: “Breaking Away: How leading finance functions are redefining excellence”, PWC, 2016)

In today’s economic climate, senior corporate executives increasingly stress the need for efficient and timely allocation of capital. In fact, this has become a front-running strategy for achieving competitive advantages and maximizing shareholder value. In particular, automation of financial processes empowers organizations to have:

- Better cash flow visibility;
- Improved spend management;
- Fewer exceptions;
- Greater accuracy; and
- Faster reconciliation.

Automating invoice processing empowers AP staff to provide real-time insight into key payment metrics such as Days Payables Outstanding, as well as useful analysis of supplier performance, including supplier discounts that can result in higher return on invested capital.

Prudent spend management translates into lower cost of goods negotiated with preferred suppliers in accordance with clear and transparent payment terms. This results in higher volume of straight-through processing for purchase order-based invoices. Less manual intervention means AP staff can focus more of their time on complex tasks such as exceptions management.

Equally troubling for corporate executives are the missed opportunities when errors are encountered on incoming invoices. Surprisingly, 68% of businesses have reported that 1% of total invoice volumes contain errors. While 1% may not appear to be material, these errors result in significant cost inefficiencies, late payment penalties, missed early payment discounts and, in some cases, increase the risk of making duplicate payments.

A Forbes article on the increased preoccupation of the C-suite with efficient capital allocation during difficult times put aptly: “Cash is King!” We’ve all heard this maxim, but today it rings truer than ever before. “A healthy profit may look nice on your financial statements, but if capital expenditures or receivable collections are draining your cash, you

won't be in business for long.” (Source: “The '8 Great' Challenges Every Business Faces,” Forbes, Cheryl Conner, March 4, 2013) This explains why AP automation can and does make a tangible contribution to help businesses optimize working capital and support efficient capital allocation.

Improved customer engagement and service levels.

Whatever the nature of a business's customers— whether consumers, businesses, citizens, clients or service partners – and no matter how they choose to communicate and interact – whether via paper, email, web, social, mobile - organizations have to make a choice. Specifically, they need to determine whether they run their business at the speed of paper, or at the speed of digital.

If the answer is digital – as it should be - then two things are required. First, the organization must eliminate paper from its processes and convert information into a digital format as soon as it comes within reach. Second, no matter via which channel or medium they are transmitted, an organization's processes, responses and the resulting customer engagement must be fast, transparent and channel agnostic.

Thus, we see the increasing importance of transforming all inbound content, documentation and forms data to a unified digital format as early as possible in any process, including via mobile capture, customer response management and digital mailroom solutions. All downstream processes can then be managed in an agile, responsive and compliant way, at maximum productivity.

Once our world is truly digital, we will have a much greater ability to react and respond to market discontinuities, new customer expectations, disruptive events, legislative changes and new innovations. Content analytics, trend projections, automated compliance and intelligent workflows simply cannot be implemented around paper. Digital on-boarding speeds up and strengthens relationships with new customers. Automatic processing of onboarded data accelerates engagement and increases customer retention. Prompt and personalized responses delight customers. And open access to digital customer data fuels the insights that fully digital businesses will use to anticipate customer needs and grow top-line revenues. Such businesses will thrive in the digital economy.

PRODUCT OVERVIEW

Our Mission

We aim to drive digital business transformation and improve customer experiences. Our business is to empower our customers to thrive and compete in the digital economy by digitizing and automating error-prone and labor-intensive document-centric business processes.

Organizations deploying our solutions are creating new customer experiences where the customer journey begins, progresses, and ends in a completely digital environment. This journey begins by transforming all inbound content, documentation, and forms data to a unified digital format at the moment the content enters the organization.

Our solutions offer advanced capture and workflow technology, superior recognition rates, innovative mobile and cloud offerings, and integration with virtually any business system along with significant improvement of straight-through processing rates.

Our market-leading eFLOW business process automation platform, which has evolved and improved over the past twenty years, is the foundation of our business process automation solutions. We empower our customers and partners to build their digital business through four principles:

Onboard inbound information. As business content enters the organization from various channels, we automatically capture and organize all data, making it understandable and digitally actionable.

Accelerate customer engagement. By automating labor-intensive, error-prone business processes, we reduce transaction costs and free customer-facing staff to focus on higher value exceptions.

Improve service levels and delight customers. We enable proactive customer response management processes based on classifying and routing inbound information to the right department for resolution, ensuring accurate personalized responses that improve service quality and build customer satisfaction.

Increase business agility. With better insight into customer sentiments and buying trends, we enable businesses to generate repeat business, foster customer loyalty, and create higher customer lifetime value.

We have established a strong footprint within three market segments, as follows:

The Banking Sector represents 37 % of our total revenue globally. Our banking focus spans across the following functionalities:

Receivables Automation: Featuring state-of-the-art cybersecurity, via our cloud-based remittance portals and document repository we provide secure distributed access to remittance data and related documents. For over 18 years we have worked with the largest financial service providers such as First Data delivering to them and to the leading financial institutions who are their customers secure cloud-based data and document management. As of the end of 2016 our remittance solution has processed over \$360 billion in remittance transactions.

Digital Mailroom for Banking: Our customers rely on eFLOW to automate their document-centric processes, including account opening, lockbox, loan origination and many more. The solution enables banks to accelerate various procedures and workflows, from change of address to account initiation, while ensuring administration of regulatory rules such as KYC (Know Your Customer) and Four-Eyes. Check verification and clearing, lockbox management, fraud detection and signature verification, credit card verification and many other document-based processes are digitized and automated to significantly improve accuracy, efficiency and customer satisfaction.

Signature Verification: Our solutions provide automated verification for signatures on any type of document, including checks, with a high degree of accuracy. Our specialized tool verifies signatures by comparing them to existing samples and identifies anomalies that may suggest forgery. Human operators are alerted when the software flags signatures as potentially fraudulent. Verification results are provided through a graphical user interface, enabling the operator to see problem areas clearly and quickly.

Content Process Automation represents 42% of our total revenue. Through a global network of channel partners, solution providers and system integrators our solutions focus on:

Forms Processing: We have implemented multiple high-volume, large scale forms processing deployments over the years, including over 30 population census processing projects for Germany, India, Brazil, Italy, Kenya, Spain, South Africa, Ireland and many other countries around the world. Recently we were selected together with a strategic partner to carry out large-scale census projects for two additional national census projects. Top Image Systems has been recognized as an approved vendor for the UNPFA (United Nations Population Fund Agency), the organization responsible for the execution of censuses worldwide.

Digital Mailroom: These solutions manage all content from multiple channels entering an organization, whether handwritten or printed, regardless of its form or origin. The data is captured, classified and delivered to persons and systems across the organization, offering powerful sorting, routing, prioritization and automatic response capabilities to ensure that all mission-critical input immediately reaches the right destination, while in parallel all routine data is handled efficiently with minimal human intervention. We have provided digital mailroom solutions to global insurance providers such as the Generali Group, Allianz, Aegon and Barmer GEK, to leading financial institutions such as Standard Chartered and Citibank, as well as to commercial enterprises across a variety of industry sectors.

Customer Response Management: These solutions provide automated responses to inquiries generated from all inbound customer communications which are digitized classified and prioritized generating actionable data that triggers a variety of workflow tasks including automated response to inquiries.

(Source: Harvey Spencer Associates, c. 2016)

Financial Process Automation Solutions represents 21% of our total revenue. Our accounts payable automation solution employs invoice capture and workflow automation to streamline and improve invoice management from the moment invoices enter the organization. Based on two decades of company experience deploying successful invoicing projects globally, our solutions reliably and efficiently integrate with businesses' core financial systems and can flexibly adapt to their IT environments.

Accounts Payable Automation: The cloud mid-market is underserved and represents sustainable growth opportunities (30% 5 Year CAGR, 2013-18: Goldman Sachs). Building on our experience digitizing over 280 million invoices annually for our customers around the world; our go-to-market strategy seeks to extend our market reach to the under-served mid-market segment for accounts payable automation, with particular focus on the cloud opportunity.

The Procure to Pay Market is growing in double digits from \$ 4.4 billion in 2013 to 6.8 billion in 2016. (Source: Forrester, 2016)

Only 40% of mid-market companies with annual revenues in the \$20 million to \$1 billion range have implemented fully automated accounts payable solutions.

AP Automation is still at an early stage of development with considerable room for growth, particularly within the mid-market segment.

(Source: Institute of Finance & Management, 2015)

Our Go-To-Market Strategy

Our strategy is to build on and extend our core document capture and process automation platform by delivering repeatable end-to-end business process automation solutions offering flexible deployment options on premise, cloud and mobile.

This strategy is designed to maximize profitability from our installed base of core document capture implementations, while transforming our business to focus on higher velocity process automation solutions, with particular initial emphasis on accounts payable automation.

Specifically, our investments focus on creating sustainable customer and shareholder value by:

1. Making our core eFLOW capture and process automation platform easier to adapt, implement and support;
2. Accelerating revenue growth from higher value process automation applications, with initial focus on accounts payable automation; and
3. Better enable our partners to implement solutions based on our product portfolio.

1. Making our core eFLOW capture and process automation platform easier to adapt, implement and support:

Our eFLOW technology comprises mechanisms and engines that leverage the latest advancements in machine learning capabilities to improve automation and continuously achieve very high recognition rates for even very complex documents, and supports all major European languages, as well as Chinese and Japanese.

We aim to constantly improve the technology, its algorithms, and its architecture, in order to maintain eFLOW's industry-leading capabilities for superior intelligent capture and recognition of complex documents.

Infrastructure and User Experience:

We have revamped the architecture of eFLOW by means of a new cloud and web-enabled architecture which supports full and easy scalability. For companies operating in a decentralized environment, eFLOW brings new potential for high performance document capture across the business, while ensuring data security for processes at every stage. Great consideration has gone into the selection of the eFLOW technology infrastructure, which is based on up-to-date technologies such as HTML5, WCF (Windows Communication Foundation), .NET, and many others. eFLOW utilizes single sign on and on-line license activation for easier installation and deployment. We expect to continue to invest in the system's infrastructure and user interfaces with the aim to simplify and enhance the user experience.

Performance and Throughput:

Servers can be seamlessly interchanged with minimal or no interruption. eFLOW's architecture uses load-balancing to ensure optimal performance of all stations at all times, deciding automatically which server will handle requests and when. In circumstances of unusually heavy loads of documents to be processed, additional servers can be added to reinforce the system's capacity to support additional users and documents, ensuring optimal performance and throughput.

Deployment Flexibility:

Today, global operations and workforces can be found in multiple locations – in the office, on the road and increasingly in home offices. Standardization across all users is key to ensure process efficiency; eFLOW aligns the user experience by providing standard client/server and browser-based web client interfaces. Powered by HTML5, our flexible web interfaces leave zero footprint, zero deployment and are device-independent. eFLOW's Web Front Office functionality allows users to split, merge, delete, sort, classify and capture documents using only a web client. The VALIDATE module includes WEB VALIDATE, a rich and accessible interface that allows an unlimited number of operators to check flagged items using only Internet-based browsers, anywhere, anytime. Enterprises can operate with maximum flexibility and efficiency by distributing their validation workload across as many stations as they choose, requiring zero footprint, no installation procedures and only minimum hardware to activate them. All of these developments work together to ensure and enhance deployment flexibility.

Performance Monitoring:

Increasingly business decisions are improved through analysis of data. With eFLOW, managers can apply service levels that measure the processing activities against expected results. The system gives straightforward insight into common inquiries, such as the volume of documents the current staff can process in a given time period, or how many hours it takes three data operators to process 10,000 documents. We aim to empower users to fully leverage the knowledge and data within eFLOW to continuously monitor and improve their operations.

Mobile Capture Platform:

The mobiFLOW SDK is a multi-purpose mobile capture and processing platform that enables capture of any document of any size using a mobile device. Our patent-pending APMI (Automatic Perfect Mobile Image) technology and embedded quality verification functionalities ensure that our applications provide the best user experience available. The "APMI" technology delivers easy-to-use "auto-capture" functionality. APMI guides the user to hover with the smartphone above a document; in the split second that the APMI technology identifies that conditions are sufficient to take the picture (based on lighting, angle, distance, stability and other parameters) it automatically takes the picture. The APMI-based application also helps the user by hinting how the handset should be held (e.g. - closer, turn right, tilt down) in order to improve image quality. Consequently, the user avoids time-consuming repetitive image creation, examination, enhancement and rejection. A high-quality image of the document is captured on the first attempt. mobiFLOW integrates seamlessly with the eFLOW capture platform to allow users to enjoy uniform access to multi-channel capture and processing.

In sum, Top Image Systems is dedicated to maintaining and enhancing our eFLOW, mobiFLOW and eFLOW CloudDocs capture and process automation platforms, reinforcing our core capture technologies with new technologies such as machine learning and extended mobile and cloud capabilities to better serve and expand our global install base.

In parallel, in response to market trends, we see growing demand for end-to-end capture and process automation solutions; to meet this demand going forward, we are also leveraging our eFLOW platform within prepackaged solutions and service applications. Initially we are focusing on developing and bringing to market an end-to-end cloud-based financial process automation solution that combines our capture capabilities with specific process functionalities to optimize accounts payable automation. Going forward, we foresee expanding this solution suite to offer additional prepackaged solutions for other specific market segments. These solutions will augment and strengthen the market presence and viability of the eFLOW platform.

2. Accelerating revenue growth from higher value process automation applications, with initial focus on delivering an end-to-end accounts payable application:

Launched in Q2 2016, our next-generation solution for AP automation inside of SAP combines the best of traditional automation solutions together with the flexibility and ease-of-use that agile companies want and need. Now, SAP organizations of any size can have it all when it comes to AP automation. Offering seamless integration with SAP, SAP HANA-certification and an integrated user experience for Accounts Payable Professionals working within their familiar SAP application environment, the new solution delivers:

- Powerful data extraction and validation
- Workflow
- Mobile capabilities
- Flexible deployment options
- SAP integration

With seamless SAP integration, our AP automation solution provides users with 360-degree visibility into invoices and related data, arming organizations with the real-time reporting and analytics required to improve operational performance, optimize cash flow, and ensure compliance, control, and security. Our best-in-class data extraction technology makes it easier and faster to get invoice information into SAP, reducing manual data entry and associated errors. The technology is self-learning, continually improving recognition rates and accuracy over time for invoices received via any delivery channel: paper, fax, email, web, mobile, EDI, or XML.

When discrepancies arise in captured data, users can quickly complete missing or incorrect fields by pointing and clicking on the required data fields appearing on the invoice images displayed within SAP. The marked values are automatically transferred into corresponding fields on the data entry screen inside SAP. The end-to-end SAP Accounts Payable solution process flow is illustrated below:

Our AP automation solution incorporates user-configurable business rules to automatically match the header and line-item data captured from invoices with critical information stored in SAP, such as the invoice date, vendor, quantity, and amount. Automatically validating this information increases the rate of invoices posted straight-through, without human operator intervention, and dramatically accelerates invoice approval cycles providing superior straight through processing of vendor invoices.

Going forward, we plan to launch the beta version of our cloud AP solution designed for the mid-market segment. As part of this initiative, we are planning to cloud-enable our on-premise AP solution delivering:

- Cloud vendor invoice capture leveraging the power, scalability and throughput of our eFLOW Extract component;
- Straight-through processing of vendor invoices in the cloud; and

Cloud-based invoice archival of vendor invoices and related documentation such as Purchase Orders and contracts, which leverages our expertise and capabilities developed within our private cloud-based remittance processing solution for the banking sector.

Since the launch of our end-to-end Accounts Payable application for SAP we have developed a robust opportunity pipeline and secured a number of initial deployments with successful rollouts.

Throughout 2016 several early adopters deployed our new AP Automation solution, including:

- An engineering and construction company operating 9 sites across Switzerland;
- A win with an European aerospace component manufacturing company;
- A win at a mid-sized European medical device manufacturer operating 10 subsidiaries;
- A win at a U.S.-based technology supplier processing invoices across global shared service centers;
- An upsell to an existing customer in the European power generation sector
- A substantial contract with an existing customer in the energy sector to deploy eFLOW AP for SAP in North, Central and South America to provide visibility into and analysis of AP processes inside their familiar SAP interface.

3. Better enable our partners to implement solutions based on our product portfolio

A key dimension of our strategy is to forge and nurture partnerships with leading technology providers, as well as with providers of document process automation solutions with global reach and focus on vertical industry solutions delivery expertise.

Our channel strategy encompasses:

- Technology partnerships such as SAP and Microsoft,
- Strategic Partners that embed our core eFLOW platform such as Xerox and FiServ; and
- Value added solution providers that deliver line of business solutions based on our core eFLOW platform.

Our network of channel partners is illustrated below:

We actively pursue new partnerships to expand our reach while nurturing our existing partnerships around the world, involving cooperation with business process outsourcing providers as well as with a variety of document services providers. Within this framework, we partner with numerous financial services providers, some of whom resell our remittance processing services and others who develop and market mobile imaging applications using our mobiFLOW SDK. During 2017 we worked closely with partners such as Fiserv as well as with TCS (Tata Consultancy Services) to support joint customers and expand joint business.

During fiscal 2016, we entered into a strategic partnership with Xerox. The partnership is built upon the two companies' track records of success over the years through a number of successful joint implementations.

Over the years, TIS and Xerox have collaborated on many large-scale document processing projects for customers around the world. Some examples include several projects in France, from contract processing for a leading telecom provider to customer communications / mailroom processing for a publishing company and for a large bank, along with invoice automation and document processing projects in the retail and energy sectors. Some other notable joint projects include mailroom automation for UWV Netherlands, the Dutch social security agency, the Argentinian Census which processed 185,000,000 forms in 6 months, invoice processing for a major Czech bank and a recent project for a telecom provider in Brazil enabling mobile customer enrollment at 3,000 retail sites.

The partnership was agreed upon and became formalized global strategy as independently validated by IDC: "On February 26, 2016, Xerox announced a global reseller agreement with Top Image Systems that provides its customers with end-to-end automation solutions for industry-specific, content-driven processes. As part of the agreement, Xerox solidified its relationship with TIS, providing Xerox with full access to TIS Enterprise Capture technologies eFLOW and mobiFLOW, which Xerox will be using as a core platform within its workflow automation solutions. These solutions will support Xerox's large enterprise customers in improving their day-to-day effectiveness and streamlining content-driven tasks, such as onboarding, claims administration, and invoice processing." (Source: "IDC Flash, Xerox Further Expands Workflow Automation Suite with the Support of Top Image Systems", Ron Glaz, 2016)

In 2016, following the signature on the global contract, we have worked together with Xerox to identify and pursue joint opportunities globally. TIS participated as a Platinum Partner at the Xerox Sales Kickoff in Canada, at the European-wide LEO Kickoff as well as at sales kickoffs in Belgium and the U.S. Both companies are investing in programmatic initiatives including marketing and sales campaigns, ramp up of sales and pre-sales training and training of Xerox and Fuji-Xerox technical teams. TIS training programs have been executed at Xerox sites around the globe, including in North, Central and South America. In the IDC Worldwide Document Workflow Services Marketscape published in September 2016, which named Xerox as one of the leading vendors, the report cites Top

Image Systems as Xerox's key partner for enterprise capture, one of only three partners mentioned in the report. While the sales cycle remains long, the pipeline arising from our joint activities has increased during the year. The companies have won two large-scale government projects in the Americas and in Asia Pacific as well as a first joint win for a large retail company in North America.

Principal Markets

As of December 31, 2017, we operated offices and branches in Israel, the United States, the United Kingdom, Germany, Hong Kong, Singapore, Australia and Japan. Our U.S. branch is responsible for sales, marketing and support activities in the United States, Canada, and Latin America. In addition, we believe that significant opportunities exist in other countries of Western and Eastern Europe, Asia and Africa. We have several local sales and technical representatives in multiple countries, these representatives manage our sales, marketing and operational activity in their locations, providing integration and implementation services, as well as marketing support.

The following table summarizes total revenues by category of activity and geographic market for each of the last three completed fiscal years:

License

Revenues by Region

(U.S. dollars in thousands)

	2015		2016		2017	
	\$	%	\$	%	\$	%
Germany	2,421	31 %	1,099	18 %	1,058	20 %
Rest of Europe	2,127	28 %	922	16 %	842	16 %
Asia Pacific	1,433	19 %	1,736	29 %	2,689	52 %
North and South America	1,343	17 %	1,961	33 %	375	7 %
Africa & Middle East	384	5 %	255	4 %	231	5 %
Total	7,708	100%	5,973	100%	5,195	100%

Service Revenues by Region

(U.S. dollars in thousands)

	2015		2016		2017	
	\$	%	\$	%	\$	%
Germany	4,881	19 %	4,164	16 %	3,957	16 %
Rest of Europe	4,658	18 %	4,016	16 %	3,666	15 %
Asia Pacific	3,837	14 %	4,191	16 %	3,733	15 %
North and South America	12,270	47 %	12,847	50 %	12,816	53 %
Africa & Middle East	437	2 %	444	2 %	296	1 %
Total	26,083	100%	25,662	100%	24,468	100%

Seasonality

Seasonality does not currently affect our business in a material manner because the seasonality of different markets substantially offset each other.

Our business significantly depends upon the requirements of large corporations and governmental agencies. As many of these entities operate according to annual budgets, their tendency is to approve budgets in the beginning of the fiscal year and release the budgets toward the end of the fiscal year. This mode of operation affects our results of operations throughout the year.

Marketing Channels

TIS continues to expand its credibility, brand recognition and presence worldwide through its channel sales program and investment in technology partnerships. TIS cooperates with over 70 partners worldwide, including Xerox, PFU (Fujitsu) Imaging Solutions, Tata Consulting Services, Cognizant, Amdocs, Hanse Orga, and Kodak. We work with numerous eFLOW® resellers worldwide as well as with leading BPOs in North America and Europe. We maintain technology partnerships with the world's leading software vendors and with a broad set of recognition engine providers as well as with BPM and specialty workflow providers.

The data capture market has recently experienced consolidation activity. Lexmark acquired Brainware and included it in Lexmark's Perceptive Software and then also acquired ReadSoft and Kofax. In April of 2016 Lexmark was acquired by a Chinese consortium. Then in May 2017 Thoma Bravo, a leading private equity firm, purchased Lexmark's Enterprise Software business, which included Kofax, Readsoft and Perceptive Software, and has consolidated the group under the Kofax brand. These events have created some new opportunities for TIS. As one of the few independent global software companies in the document automation space, a company offering a rich portfolio of advanced mobile and cloud-based intelligent processing solutions, TIS is positioned to benefit from present market dynamics by establishing partnerships with companies seeking to replace their capture and workflow vendor. For example, we now have an enhanced opportunity to pursue business relationships with companies in competition with Kofax.

We are constantly monitoring the effect of consolidation and other changes in the marketplace and their impact on our business. While customer transactions via partners tend to take more time to finalize and to be more complex, partnerships are the entry point to a greater pool of larger transactions. Approaching transactions in cooperation with partners offering skills and functionalities complementary to ours often improves our chances of winning contracts.

In parallel, TIS is actively strengthening its joint go-to-market strategy with Xerox Workflow Automation and other strategic partners in order to sell comprehensive end-to-end solutions leveraging the eFLOW platform – together with partner software and services – to better meet customer demand and to expand our sales capacity.

Partnerships are also key in the area of mobile imaging, a line of business where our strategy is to accelerate our presence primarily through developing partnerships for sales. TIS has signed agreements with well-known suppliers to the US financial industry such as with a division of Jack Henry & Associates that is now Alogent, and Fiserv, one of the leading global solution providers to banks and other financial institutions. TIS is developing a broad network of mobile imaging partners to maximize its market access to this large, dynamic and fast growing sector.

Competition

Competition in the multichannel capture, workflow and delivery market is intensifying. The market is fragmented and is characterized by numerous local applications, varying requirements, a multitude of specific vertical solutions and various combined software offerings to customers. Competitors usually focus on one or more key business processes

and their solutions address differing needs which vary according to company size, industry, geography and platform. Within the ECM lifecycle, TIS is focused primarily on the imaging and capture phase along with integrated, embedded BPM workflow capabilities. The big three ECM players (IBM, Opentext, and Oracle) primarily focus on the stages that follow Capture, meaning BPM, content storage (archiving) and records management.

In contrast to solutions offered by smaller market players, the eFLOW® platform was built from the ground up and covers the entire spectrum of capture and imaging solutions. This stands in contrast with applications which focus only on specific areas such as Accounts Payable. The data capture/imaging market is highly fragmented with more than 50 players and, as described above, is trending toward consolidation. We compete with Kofax, Open Text, IBM (which acquired Datacap), EMC Captiva (acquired by Dell), Oracle, Banctec, Basware, Hyland (who acquired AnyDoc), eCopy, Global360 (acquired by OpenText), Ikon, Itesoft, Nuance, Parascript, Scansoft, Scan Optics, as well as a variety of manual data entry systems. Newer participants capturing interest and market share include Esker, Ephesoft, Coupa and Concur in the AP space.

In the United States and Europe, we often compete with multiple competitors supplying similar solutions. In the Asia Pacific region we compete mainly against local technology providers and the large global competitors. TIS competes in global and regional tenders as well as in the open market.

In the area of mobile capture and payments, we compete primarily with Mitek Systems, Inc., the first company to market in the mobile capture space, and which is currently mostly active in the US. While the market for mobile capture solutions is still relatively young, we believe it is very large, growing larger, and rapidly changing. We welcome competitive activity which we believe serves primarily to educate the market and increase prospects' confidence.

In the remittance processing arena, our solutions compete mostly with the solutions of Wausau (recently acquired by Deluxe) as well as with in-house solutions.

Third Party Technology

We license various recognition software technologies from third parties in order to incorporate them in our products. We currently use technologies developed by several different companies. Depending upon the requirements of each customer, we incorporate one or several of such technologies into a specific product. We are not dependent upon any single source of recognition software technology and the various technologies that we use are, in large part, interchangeable.

Intellectual Property Rights

Our success depends upon our proprietary software technology. We rely on trade secret protection, employee and third-party nondisclosure agreements and other intellectual property protection methods to protect our confidential and proprietary information. In addition, we are engaged in efforts to protecting our intellectual property through the filing of patent applications. Despite these efforts, we cannot be certain that others will not otherwise gain access to our trade secrets or copy and use information that we regard as proprietary without our authorization. None of our patent applications have yet been productive of a patent and we cannot assure you that we will file for or obtain any patents. In addition, we cannot assure you that:

- any patents which we may obtain will be broad enough to protect our technology, will provide us with competitive advantages or will escape challenge or invalidation by third parties;
- the patents of others will not have an adverse effect on our ability to do business; or
- others will not independently develop similar products, duplicate our products or, if patents are issued to us, design around these patents.

Further, the laws of foreign jurisdictions where we sell and seek to sell our products may afford little or no protection of our intellectual property rights. We cannot assure you that the protection provided to our intellectual property rights by the laws and courts of foreign nations will be substantially similar to the remedies available under U.S. law.

We believe that our technology has been developed independently and does not infringe on the proprietary rights of others. However, we cannot assure you that the technology does not and will not infringe or that third parties will not assert infringement claims against us in the future. In the case of infringement, we would, under certain circumstances, be required to modify our products or obtain a license. We cannot assure you that we would be able to do either in a timely manner under acceptable terms and conditions or at all, or that we will have the financial or other resources necessary to defend successfully a patent infringement or other proprietary rights infringement action. Further, even if we were not infringing, intellectual property litigation is expensive and time consuming for management. Failure to do any of the foregoing could have a material adverse effect on us. Furthermore, if our products or technologies are deemed to infringe upon the rights of others, we could become liable for damages, which could have a material adverse effect on us.

In addition, we license components of our software systems and technology from third parties in reliance on such parties' representations as to ownership of the licensed intellectual property. If our licensors are found not to own or have rights to sublicense such rights to us and we are unable to replace the licensed technology with a comparable substitute, there could be a material adverse effect on our business prospects and financial results. Even if we were to replace licensed technology with available alternatives, it could take time to identify the best replacement and to fully integrate it into our software. The delay and uncertainty could negatively impact our financial results.

We believe that product recognition is an important competitive factor in the form processing industry. Accordingly, we promote the eFLOW® name in connection with our marketing activities. On March 10, 2009, the United States Patent and Trade Office (the "USPTO") registered a trademark for one of our significant solution and module names, namely eFLOW®, for computer software applications; namely, software applications that process and integrate data provided from various sources across a single platform, in Class 9 (U.S. CLS. 21, 23, 26, 36 and 38).

Likewise, on May 26, 2009, the USPTO registered our trademark TIS® for use in connection with "Application service provider (ASP) featuring software, technical consultation and technical assistance in the field of computer systems and installation, maintenance, and updating of computer software" in International Class 042 (U.S. CLS. 100 and 101). Similarly, on May 26, 2009, the USPTO registered our trademark TOP IMAGE SYSTEMS® for use in connection with "Technical consultation in the field of computer systems; technical assistance in the nature of technical support services, namely, troubleshooting of computer hardware and software systems; installation, maintenance and updating of computer software", in International Class 042 (U.S. CLS. 100 and 101).

Warranty and Service

We generally negotiate our warranty obligations with respect to our products on a case-by-case basis. Normally our warranty period is up to three months. We may be exposed to potential product liability claims by our customers and users of our products. Currently, we hold worldwide product liability insurance and professional indemnity policies that provide coverage limited to different amounts up to \$9 million. Despite this coverage, a successful claim against us for product liability could have a material adverse effect on our financial condition. While we have not experienced material warranty liability in the past, we cannot assure you that future warranty expense will not have an adverse effect on us.

We have various maintenance and support agreements with many of our customers. These agreements typically provide us with regular payments of fees ranging 15-25% per annum of the applicable license fees. Our technical team also provides support to value-added resellers, distributors and systems integrators to assist in the integration of our products.

Governmental Regulation

NTIA is the Israel Innovation Authority previously known as the Office of the Chief Scientist of Israel's Ministry of Economy. Its mission is to assist the advancement of Israel's knowledge-based science and technology industries in order to encourage innovation and entrepreneurship while stimulating economic growth. The government of Israel encourages research and development projects through the NTIA under the Law for the Encouragement of Research, Development and Technological Development in Industry, 1984. We have received grants from the NTIA to finance a portion of our research and development expenditures in Israel. Such grants generally bear royalties on sales of products utilizing technologies developed using such grants or arising out of such technologies up to a maximum of 100% of the amount of the grant, linked to the dollar, plus interest at the LIBOR rate. The grants received during 2012, 2013, 2014, 2015, 2016 and 2017 totaled \$0.7. During 2017 we received grants from the NTIA totaling\$.2. The Israeli government may decide not to continue the program in the future at its current level or to terminate it altogether or the NTIA may not accede to future grant requests from us. In addition, if we fail to comply with any of the conditions imposed by the NTIA, including the payment of royalties with respect to grants received, we may be required to refund any payments previously received from the NTIA, together with interest and penalties. The terms of the NTIA grants limit our ability to transfer technologies outside of Israel without the prior approval of the NTIA, if such technologies were developed using NTIA grants or arose out of such technologies. The NTIA has the right, but not the obligation, to allow transfer of technology outside of Israel. Even if we receive approval for the transfer of technology outside of Israel, such approval of the NTIA may not be obtained on terms that are acceptable to us, or at all.

We also benefit from being designated as an "Approved Enterprise" and as Benefited Enterprise under Israel's Law for the Encouragement of Capital Investments, 1959. For additional information, see the section below entitled "Additional Information - Law for the Encouragement of Capital Investments, 1959."

Additionally, we may be subject to varied regulation in the markets where we sell our products. The burden of complying with such regulatory schemes (which may be contradictory) could have a material adverse effect on our ability to diversify or grow our sales.

Recent developments have heightened both public focus and the commercial need for solutions with respect to the processing of personally identifiable information. In addition, on May 25, 2018, the General Data Protection Regulation will come into effect in the European Union and will introduce new privacy and compliance requirements concerning the collection of data and could potentially subject violators to heavy fines. The new rules regulate data concerning European persons even if it is collected and stored outside the European Union, and have further increased global attention to collection, protection, and storage procedures. As Top Image Systems operates in the EU as well as provides goods and services to EU residents compliance with GDPR is required. Pursuant to Article 3 of GDPR, Top Image Systems is deemed to be an "establishment of a processor" and therefore falls within the scope of GDPR. Accordingly, the company is updating its privacy notice and policies to ensure compliance with enhanced privacy rights.

Organizational Structure

Top Image Systems Ltd. has a number of subsidiaries worldwide, the most significant and operational of which are the following wholly owned subsidiaries:

¾T.I.S America Inc. (incorporated in Delaware);

¾Tis Americas Inc. (incorporated in Delaware) formerly named eGistics Inc. (a subsidiary of T.I.S America Inc.)

¾Top Image Systems UK Limited (incorporated in the United Kingdom);

³/₄ Top Image Systems (2007) UK Limited (incorporated in the United Kingdom), formerly known as CPL;

³/₄ TIS Deutschland GmbH (incorporated in Germany);

³/₄ Top Image Systems (Asia Pacific) Pte. Ltd (incorporated in Singapore), formerly known as Asiasoft Global Pte Ltd;

³/₄ TIS Japan Ltd. (incorporated in Japan); and

³/₄ Top Image Systems Pty Ltd. (incorporated in Australia)- 51% of its shares are owned by Top Image Systems Ltd.

Top Image Systems (Singapore) Pte. Ltd is a wholly-owned subsidiary of Top Image Systems (Asia Pacific) Pte. Ltd, formerly known as Asiasoft Global Pte. Ltd.

Property, Plant and Equipment

Our principal executive offices are located in Ramat Gan, Israel and our principal business and service operations are located in Cologne, Germany; Frankfurt, Germany; Plano, TX, USA; Tokyo, Japan; and Singapore. We also have regional offices in Hong Kong and Australia.

All facilities are leased. The following table sets forth details of the square meters and approximate monthly rental fees in U.S. dollars of our main current leased property, all of which are fully utilized:

Facility	Monthly rent in USD (approximate)	Square meters (approximate)	Expiration date
Ramat Gan, Israel	13,700	670	Month to Month
Cologne, Germany	17,200	740	2021
Tokyo, Japan	3,800	120	2019
Hong Kong	2,000	100	2019
Plano, TX, USA	13,200	1,153	2019
Singapore	10,100	200	2019
Frankfurt, Germany	5,100	275	2020

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Management's discussion and analysis of financial condition and results of operations

You should read the following discussion of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes and other financial information contained elsewhere in this annual report. This discussion contains forward-looking statements that involve risks and uncertainties, including those discussed in "Item 3. Key Information—Risk Factors." See "Forward-looking statements" at the beginning of this annual report.

Overview

We develop and market automated data capture solutions for managing and validating content gathered from customers, trading partners and employees. Whether originating from electronic, paper, mobile or other sources, our solutions deliver digital content to the applications that drive an enterprise by using advanced technologies including wireless communications, servers, form processing and information recognition systems. Our software improves business processes by integrating different types of data from multiple sources. Our products integrate information regardless of the source and format of the data, whether structured, as in the case of application forms or surveys, or semi-structured, such as invoices, purchase orders, checks, freight and shipping bills and others. Our solutions seamlessly deliver the extracted data to applications such as document and content management, enterprise resource planning, or customer relationship management. Our solutions minimize the need for manual data entry by automatically reading, identifying, interpreting and processing information, thereby increasing data capture accuracy and the rate of information processing. The platform solution we offer replaces traditional means of extracting information from paper-based documents and integrates multiple information sources into a single enterprise-level solution that increases speed and efficiency.

We develop and market our software solutions to wide range of customers, based on one end-to-end solution that automatically classifies, recognizes and understands data processed into the organization systems. We process, validate and integrate the data into ERP, CRM and workflow systems, while our solution, eFLOW® Unified Content Platform, performs business-critical key data capture, lying within incoming documents (paper forms, eForms, fax, image files, microfiche and electronic).

Sales Cycle

Our sales to end-user customers, value-added resellers, distributors and system integrators, all of which we consider to be our end-users, are made on open credit terms and we do not hold collateral to secure payment. The terms of the arrangements with these customers, generally, do not provide them with the right to return the purchased products or

solutions. Payment with respect to such sales is generally due within a specified period following receipt of an invoice. The period varies from customer to customer, but usually we provide credit terms of up to 120 days for end-user customers and up to 180 days for resellers, distributors and system integrators. In some arrangements, management can offer longer payment terms as mentioned above, evaluating business sense, creditworthiness of the customer and other facts needed to establish such decision.

Our sales cycle for eFLOW® solutions ranges from 9 to 15 months. These sales cycles vary by customer and could extend for longer periods depending on the time required by the customer to evaluate the utility of the applicable product to its operations. Our operating results could vary between periods as a result of this fluctuation in the length of our sales cycles, the purchasing patterns of potential customers, the timing of introduction of new products and product enhancements introduced by us and our competitors, technological factors, variations in sales by distribution channels, competitive pricing and generally non-recurring product sales. Consequently, our product revenues may vary significantly by quarter.

Geographical Considerations

The following table summarizes total revenues by geographic market for each of the last three completed fiscal years.

Revenues by Region

(U.S. dollars in thousands)

	2015		2016		2017	
	\$	%	\$	%	\$	%
Germany	7,302	22 %	5,263	17 %	5,015	17 %
Rest of Europe	6,785	20 %	4,938	16 %	4,507	15 %
Asia Pacific	5,270	16 %	5,927	18 %	6,422	22 %
North and South America	13,613	40 %	14,808	47 %	13,191	44 %
Africa & Middle East	821	2 %	699	2 %	528	2 %
Total	33,791	100%	31,635	100%	29,663	100%

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements in conformity with generally accepted accounting principles in the United States requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period, which could potentially result in materially different results under different assumptions and conditions. These are our management's best estimates based on experience and historical data; however, actual results could differ materially from these estimates. Our significant accounting principles are presented within Note 2 to our consolidated financial statements attached to this annual report. While all the accounting policies impact the financial statements, certain policies may be viewed to be critical. Management believes that the following policies are those that are most important to the portrayal of our financial condition and results of operations and are the most critical to aid in fully understanding and evaluating our reported results:

- Revenue recognition
- Allowance for doubtful accounts
- Contingencies and accrued expenses
- Share-based compensation
- Income taxes

Revenue Recognition

We report our revenue in two categories: license revenue and services revenue. License revenue includes perpetual or term licenses. Service revenue includes cloud services, professional services and post-contract customer support ("PCS"). Our arrangements for license our cloud offerings often contain multiple other elements, including professional services and PCS.

We recognize revenue in accordance with ASC 985-605, "Software Revenue Recognition ("ASC 985-605"), which generally requires revenues earned from software arrangements involving multiple elements to be allocated to each element based on the relative fair values of the elements. Software revenue recognition requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor's specific objective evidence ("VSOE") of fair value exists for those elements. Revenues are allocated using the residual method when a license arrangement includes multiple elements.

Revenue from license fees is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable. PCS revenue is deferred and recognized on a straight-line basis over the term of the agreement. Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement.

For sales that do not included a perpetual software, we recognize revenues in accordance to Accounting Standards Update ("ASU") No. 2009-13, Topic 605 - Multiple-Deliverable Revenue Arrangements ("ASU 2009-13"). ASU 2009-13 requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price.

The selling price for a deliverable is based on its vendor-specific objective evidence ("VSOE") if available, third-party evidence ("TPE") if VSOE is not available, or estimated selling price ("ESP") if neither VSOE nor TPE is available. The Company then recognizes revenue on each deliverable in accordance with its policies for product and service revenue recognition. TPE of selling price is established by evaluating largely interchangeable competitor products or services in stand-alone sales to similarly situated customers. However, as our products contain a significant element of proprietary technology and its solutions offer substantially different features and functionality, the comparable pricing of products with similar functionality typically cannot be obtained.

Deferred revenues represent amounts received by customers and not yet recognized. We generally do not grant a right of return to our customers.

Allowance for doubtful accounts

We maintain an allowance for doubtful accounts for estimated losses inherent in our accounts receivables portfolio. In establishing the required allowance, we base our determination, among other factors, on information available about the debtors' financial condition, the volume of their operations and our evaluation of the security received from them. Account balances are charged against the allowance after all means of collection have been exhausted and the potential for recovery is determined to be remote.

Contingencies and Other Accrued Expenses

We are, from time to time, involved in claims, lawsuits, government investigations, and other proceedings arising from the ordinary course of our business. We record a provision for a liability when we believe that it is both probable that a liability has been incurred, and the amount can be reasonably estimated. Significant judgment is required to determine both probability and the estimated amount. Such legal proceedings are inherently unpredictable and subject to significant uncertainties, some of which are beyond our control. Should any of these estimates and assumptions

change or prove to have been incorrect, it could have a material impact on our results of operations, financial position and cash flows. If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material.

Share-based compensation

We have selected the Monte-Carlo option-pricing model to determine the fair value of our awards on the date of grant. Determining the fair value of equity-based awards on the grant date requires the exercise of judgment, including the amount of equity-based awards that are expected to be forfeited. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from our current estimates.

Although management believes that their estimates and judgments about equity-based compensation expense are reasonable, actual results could differ.

Income taxes

We account for income taxes in accordance with ASC 740, "Income Taxes". 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 bases of 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. We provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

We account for uncertain tax positions in accordance with the provisions of ASC No. 740 "Income Taxes". This accounting guidance addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements, under which a Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. Accordingly, we report a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. We recognize interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

Recently Enacted Accounting Pronouncements

In May 2016, the FASB issued ASU 2016-11, "Revenue Recognition: Customer Payments and Incentives", which clarifies the guidance in recognizing costs for consideration given by a vendor to a customer as a component of cost of sales. This ASU is effective for annual and interim periods beginning after December 15, 2017. We expect to adopt the standard under the modified retrospective method. However, we are continuing to evaluate the impact of the standard, and its adoption method is subject to change. We are in the process of analyzing our contracts to quantify the impact that the adoption of the standard will have on revenue.

In March 2016, the FASB issued ASU 2016-09, "Compensation – Stock Compensation", which effects all entities that issue share-based payment awards to their employees. The amendments in this ASU cover such areas as the recognition of excess tax benefits and deficiencies, the classification of those excess tax benefits on the statement of cash flows, an accounting policy election for forfeitures, the amount an employer can withhold to cover income taxes and still qualify for equity classification and the classification of those taxes paid on the statement of cash flows. This ASU was effective for annual and interim periods beginning after December 15, 2016. The Company has determined that adoption of this method had no material impact on the financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases" (Topic 842), which requires lessees to record a right-of-use asset and a lease liability on their balance sheets.

Topic 842 supersedes the previous leases standard, ASC 840, "Leases". The guidance is effective for the interim and annual periods beginning on or after December 15, 2018, and early adoption is permitted. The Company has elected not to early adopt this standard. The Company expects that most of its operating lease commitments will be subject to Topic 842 and will be recognized as right-of-use assets and lease liabilities upon adoption with no material impact on its results of operations or cash flows.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" and issued subsequent amendments to the initial guidance in August 2015, March 2016, April 2016, May 2016 and December 2016 within ASU 2015-04, ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2016-20, respectively, (collectively referred to as Topic 606). These updates supersede the revenue recognition requirements in ASC Topic 605, "Revenue Recognition" and nearly all other existing revenue recognition guidance under U.S. GAAP. The core principal of Topic 606 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services and permits the use of the retrospective or cumulative effect transition method. Topic 606 identifies five steps to be followed to achieve its core principal, which include (i) identifying contract(s) with customers, (ii) identifying performance obligations in the contract(s), (iii) determining the transaction price, (iv) allocating the transaction price to the performance obligations in the contract(s) and (v) recognizing revenue when (or as) the entity satisfies a performance obligation.

We anticipate that we will adopt Topic 606 using the cumulative effect approach when this guidance becomes effective for us, starting in the first quarter of 2018. The Company has determined that implementation of the standard will have not have material impact on its financial statements.

Results of Operations

The following table sets forth the percentage relationships of certain items from our consolidated statements of operations, as a percentage of revenues for the periods indicated:

	Year ended December		
	31, 2015	2016	2017
	%	%	%
License revenues	22.8	18.9	17.6
Service revenues	77.2	81.1	82.4
Total revenues	100.0	100.0	100.0
Cost of License revenues	1.6	2.2	1.9
Cost of service revenues	46.1	51.0	54.2
Total Cost of revenues	47.7	53.2	56.1
Gross profit	52.2	46.8	43.9
Operating costs and expenses:			
Research and development, net	14.2	14.5	16.8
Selling and marketing	32.2	23.5	20.3
General and administrative	22.2	21.8	22.2
Acquisition related costs	-	-	-
Amortization of intangible assets	1.2	1.6	2.1
Restructuring Charges	-	3.6	1.9
Total operating costs and expenses	69.8	65.0	63.3
Operating loss	(17.5)	(18.2)	(19.5)
Financial expenses, net	(3.4)	(3.0)	(2.0)
Other income, net	0.0	0.0	0.0
Loss from continuing operations before taxes on income	(20.9)	(21.2)	(21.5)
Taxes on income (income tax benefits)	(3.6)	0.4	(0.7)
Net loss	(24.5)	(20.9)	(22.2)
Attributable to:			
Non- controlling interest	0.0	0.0	0.0
Company's shareholders	(24.5)	(20.9)	(22.2)

Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

Revenues. Total revenues for the year ended December 31, 2017 amounted to \$29.7 million compared to \$31.6 million for the year ended December 31, 2016, a decrease of 6.2%. The decrease in revenues was driven by a decrease in product revenues of \$.8 million, or 13%, from \$6.0 million in 2016 to \$5.2 million in 2017. Service revenues decreased by \$1.3 million, or 5.0%, from \$25.7 million in the year ended December 31, 2016 to \$24.4 million in the year ended December 31, 2017. The decrease in product revenues was mostly a result of longer sales cycles, and fewer eFlow license sales.

Cost of Revenues. Cost of Revenues decreased by 1%, from \$16.8 million in 2016 to \$16.7 million in 2017. The decrease of \$.1 million is attributed mainly to reduction in personnel.

Gross margin decreased by 2.9% from 46.8% gross margin in 2016 to 43.9% gross margin in 2017, as a result of lower revenues in 2017. Most of our expenses are fixed, which causes a decrease in gross margin when revenues decline.

Research and Development, net. Research and Development expenses increased by 9%, from \$4.6 million in 2016 to \$5.0 million in 2017. This increase is primarily a result of an increase in development resources during the year and the addition of a Senior VP of Engineering.

Selling and Marketing. Selling and Marketing expenses amounted to \$7.5 million in the year ended December 31, 2016 and \$6 million in the year ended December 31, 2017. This 20% decrease is primarily a result of a restructuring process we initiated, where the number of sales employees was reduced and thus the decrease in payroll and commissions.

General and Administrative. General and Administrative expenses in the year ended December 31, 2017 was \$6.6 million, compared to \$6.9 million for the year ended December 31, 2016. This decrease of 4.3% is mainly a result of restructuring process we initiated, where the number of employees was reduced and thus the decrease in payroll

Financial expenses, net. Our net financial expenses for the year ended December 31, 2017 decreased to \$.6 million from \$1 million for the year ended December 31, 2016.

Tax on income. In 2017, we recorded a net tax expense in the amount of \$0.2 million.

Net (loss) income. As a result of a decrease in our costs, in addition to a decrease in revenues as described above, we incurred a net loss of \$6.6 million in 2017, compared to net loss in the amount of \$6.6 million in 2016.

Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

Revenues. Total revenues for the year ended December 31, 2016 amounted to \$31.6 million compared to \$33.8 million for the year ended December 31, 2015, a decrease of 6.3%. The decrease in revenues was driven by a decrease in product revenues of \$1.7 million, or 22.5%, from \$7.7 million in 2015 to \$6.0 million in 2016. Service revenues decreased by \$0.4 million, or 1.6%, from \$26.1 million in the year ended December 31, 2015 to \$25.7 million in the year ended December 31, 2016. The decrease in product revenues was mostly a result of slower sales cycles, and fewer eFlow license sales.

Cost of Revenues. Cost of Revenues increased by 4.2%, from \$16.1 million in 2015 to \$16.8 million in 2016. The increase of \$0.7 million is attributed mainly to additional hardware costs related to some of our revenues.

Gross margin decreased by 5.4% from 52.2% gross margin in 2015 to 46.8% gross margin in 2016, as a result of lower revenues in 2016. Most of our expenses are fixed, while there was a decrease in revenues, which caused the decrease in gross margin.

Research and Development, net. Research and Development expenses decreased by 4.5%, from \$4.8 million in 2015 to \$4.6 million in 2016. This decrease is primarily a result of lower use of contractors in 2016 and lower travel costs.

Selling and Marketing. Selling and Marketing expenses amounted to \$10.9 million in the year ended December 31, 2015 and \$7.5 million in the year ended December 31, 2016. This 31.6% decrease is primarily a result of a restructuring process we initiated, where the number of sales employees was reduced and thus the decrease in payroll and commissions.

General and Administrative. General and Administrative expenses in the year ended December 31, 2015 amounted \$7.5 million, compared to \$6.9 million for the year ended December 31, 2016. This decrease of 7.8% is mainly a result of restructuring process we initiated, where the number of sales employees was reduced and thus the decrease in payroll

Restructuring charges. During 2016 the company has executed a restructuring process. The total expenses related to this process in 2016 were \$1.1 million.

Financial expenses, net. Our net financial expenses for the year ended December 31, 2016 decreased to \$1.0 million from \$1.1 million for the year ended December 31, 2015

Tax on income. In 2016, we recorded a net tax income in the amount of \$0.1 million. This tax income is mostly a result of current tax expenses in Germany.

Net (loss) income. As a result of a decrease in our costs, primarily after a restructuring process held in 2016, in addition to a decrease in revenues as described above, we incurred a net loss of \$6.6 million in 2016, compared to net loss in the amount of \$8.3 million in 2015.

Impact of Currency Fluctuation

We maintain operations and generate revenues in a number of countries. The results of operations and the financial position of some of our local operations are generally reported in the relevant local currencies and then translated into U.S. dollars at the applicable exchange rates for inclusion in our consolidated financial statements, exposing us to currency translation risk. In addition, we are exposed to currency transaction risk because some of our expenses are incurred in a different currency from the currency in which our revenues are received and from which our revenues and expenses are reported. Our most significant currency exposures are to the Euro, New Israeli Shekel, British Pound, Singapore dollar, Australian dollar, Japanese Yen and Brazilian Real. In periods when the U.S. dollar strengthens against these currencies our revenue may be decrease when expressed in US dollars. In periods when the U.S. dollar weakens against these currencies, our expenses may increase when expressed in US dollars.

Political and Economic Conditions in Israel Affecting our Business

Because our principal offices are located in Israel, political, economic and military conditions in Israel directly affect our 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. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. There has been a marked increase in such hostility and a significant deterioration of Israel's relationship with the Palestinian Authority since October 2000 and the peace process is currently at a standstill. Since 2011 there has been increasing instability in neighboring Arab countries including Syria, Egypt, Jordan, Tunisia, Libya, Bahrain, and Yemen culminating in the replacement of certain leaders in some of those countries and the control of territories by extremist Islamic groups. In addition, there is a high level of tension relating to Iran's nuclear capabilities, Iran's threats to attack Israel, Iran's military presence in Syria, and the potential response of Israel and the international community to Iran's gaining nuclear capabilities. Civil war in Syria has intensified and has become increasingly complex over recent months resulting in volatile developments in the region. Stray rounds

from the conflict have landed in Israel from time to time and there have been cross-border skirmishes which increase the risk of escalation.

41

In December 2017 the United States announced a plan to move the United States embassy in Israel from Tel Aviv to Jerusalem drawing criticism from Arab and European leaders and spurring protests in Israel. Jerusalem is one of the world's most fiercely contested areas as it is claimed by both Palestinians and Israelis. The United States' moving its embassy may have an impact on efforts to create peace between Israel, Palestinians and Israel's Arab neighbors.

Continuing or escalating instabilities and hostilities in the region or curtailment of trade between Israel and its present trading partners as a result or in response to such instabilities may have an adverse effect on our business conditions, including our ability to develop, manufacture and market our products.

Generally, all male adult citizens and permanent residents of Israel under the age of 42 (or older, for citizens who hold certain positions in the Israeli armed forces reserves) are obligated, unless exempt, to perform military reserve duty annually and some of our employees in Israel are so obligated. Moreover, in the event of armed conflict in which Israel is involved or the threat of such conflict, these employees might be called for active military duty for an unlimited period of time. Increased military activity could also result in a reduction of prospective qualified employees available to work for us to expand our business or replace employees on active military duty.

Economic Conditions

The Israeli government's monetary policy contributed to relative price stability in recent years. Economic growth has continued in recent years, though at varying rates. We cannot assure you that the Israeli government will be successful in its attempts to keep prices stable or that economic growth will continue. Price volatility or a decrease in growth rates may have a material adverse effect on our business.

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 also a member of the World Trade Organization and is a signatory of the Global Agreement on Trade in Services and the Agreement on Basic Telecommunications Services. In addition, Israel has been granted preferences under the Generalized System of Preferences by Canada and has other trade preferences from the United States, Australia and other countries. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs. Israel is also a member in the Organization of Economically Developed Countries. Israel and the European Economic Community, now known as the European Union, signed a Free Trade Agreement in 1975. This agreement confers advantages on Israeli exports to most European countries and obligates Israel to lower its tariffs on 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 EFTA (European Free Trade Association), which includes Austria, Norway, Finland, Sweden, Switzerland, Iceland and Liechtenstein, established a free trade zone between Israel and the EFTA nations. Free trade treaties exist with a number of other countries and are being negotiated with others. We cannot assure you that our ability to conduct trade in the international market will be unhindered by political developments in our region.

Liquidity and Capital Resources

As of December 31, 2017, we had \$2.2 million in cash, cash equivalents, compared to \$7.6 million as of December 31, 2016.

Our capital resources are derived from our operating activities as well as from our financing activities. In 2017, we used \$2.6 million of cash in operating activity compared to \$2.0 million in 2016. The increase in cash used by operating activities in 2017 compared to 2016 was mainly attributed an increase in accrued expenses, in addition to a decrease in trade receivables.

We believe that our current cash, cash equivalents and cash deposits, our forecasted positive cash flows for future periods, and potential borrowings under the Senior Loan will be sufficient to meet our on-going operations for the next twelve months.

Net cash used by investing activities for the year ended December 31, 2017 was \$.6 million compared to \$.1 million in 2016. In 2017, net cash used in investing activities consisted primarily of cash paid for purchase of property and equipment.

For the years ended December 31, 2017 and 2016, our aggregate capital expenditures were \$0.6 million and \$0.2 million, respectively. These expenditures were principally for the purchases of computer hardware and software.

Net cash provided used by financing activities was \$2.2 million in 2017 compared to \$7.4 million in 2016. The cash provided by financing activities was mostly attributable to an investment we received from HCP FVE in 2016 and from a short term bank loan.

In December 2017, we secured a \$2.5 million line of credit with a U.S. based bank. The line is secured by the accounts receivables of our U.S.subsidiary and bears interest at 2.5% or 3% (if in stream line mode) per annum and matures in December 2018. We had borrowings outstanding of \$0.8 million against the line of credit at December 31, 2017. Subsequent to December 31, 2017, the borrowings under the line were repaid and the line was cancelled.

In May 2018, in order to provide the Company with additional liquidity if needed, we entered into the Term Sheet with Hale Capital Partners which provides for a Senior Loan in an amount of up to \$3 million as part of the secured Credit Facility that would include the existing Convertible Note held by an affiliate of Hale in an amount of \$5.6 million. The Senior Loan would include monthly repayments of \$50,000 in 2019 and \$100,000 from January 2020 through maturity (such amount to increase on the happening of certain events), an interest rate of Prime plus 5% payable monthly and a 36-month term. The Credit Facility will be secured by the Company's assets and will be guaranteed by each of our subsidiaries, subject to certain limitations. The Senior Loan would be required to the prepaid on certain events and would be prepayable at the Company's option at a premium beginning one year following closing.

In December 2016, we borrowed \$5 million from HCP-FVE, LLC, an affiliate of Hale Capital Partners in exchange for the Convertible Note which bears interest at the prime rate plus 2.5% (if paid in cash) or 3% (if the interest capitalized) per annum and matures (if not converted prior) in December 2020. Upon withdrawal from the Credit Facility, the Convertible Note, plus accrued interest, will be exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0%.

The Company has not yet determined if it will draw on the Credit Facility. The issuance of the warrants and the changes to the Convertible Note are conditioned upon the drawing down of the Credit Facility. If the Company elects not to withdraw funds out of the Credit Facility, it will be obligated to pay to Hale Capital Partners, LP a break up fee of equal to three percent (3%) of the Credit Facility.

Research and Development, Patents and Licenses

In order to accommodate the rapidly changing needs of our markets, we place considerable emphasis on research and development projects designed to improve our existing product lines and to develop new product lines to meet the changing needs of our market. In 2017, as part of our efforts to strengthen our position, we continued investing in research and development with expenses level of \$5.0 million, compared to \$4.6 million in 2016, and to \$4.8 million in 2015. As of December 31, 2017, 34 of our employees were engaged primarily in research and development activities. We expect that we will continue to commit substantial resources to research and development in the future. For further details about our product see “Business Overview - Products and Solutions”.

Off-Balance Sheet Arrangements

We are not a party to any material off-balance sheet arrangements.

Tabular disclosure of contractual obligations.

The following is a summary of our significant contractual obligations as of December 31, 2017:

	Total	Payment due by period (\$ thousands)			
		Less Than		More than	
		1 Year	1-3 Years	3-5 Years	5 Years
Contractual Obligation*					
Operating and Capital Lease Obligation	2,569	1,183	1,386	-	-
Accrued severance pay**	6721	-	-	-	721

*Our contractual obligations and commitments at December 31, 2017 principally include obligations associated with our operating and capital lease obligations and contractual and legal obligations related to employees and officers’ severance expense. Such obligations are detailed in Note 8 to the consolidated financial statements for the year ended December 31, 2017 as well as the section entitled “Compensation” herein. We expect to finance these contractual commitments from cash on hand and cash generated from operations.

**Severance pay related to accrued obligations to employees as required under applicable labor law. These obligations are payable only upon termination, retirement or death of the respective employee.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

The following table sets forth the identity of our directors, and senior management as of March 31, 2018. The mailing address for each of the individuals below is c/o TIS at our address set forth herein.

Name	Age	Title
Donald R. Dixon	70	Chairman of the Board
Brendan Reidy	64	Chief Executive Officer
Patti Barton	57	Acting Chief Financial Officer
Martin Hale	46	Director
Izhak Nakar	67	Director
Ido Schechter	57	Director
Osnat Segev-Harel	56	Director

Donald R. Dixon was appointed Chairman of the Board beginning in January 2017. He was first elected to serve as a director in July, 2014. Mr. Dixon is also a Managing Director of Trident Capital and co-founded the firm in 1993. Currently, Mr. Dixon serves also as a director of 2Checkout, Advanced Payment Solutions, Amprius, Odyssey Logistics, Qualys (QLYS), SivaPower and Tiandi Energy. Mr. Dixon is also on the investment committee of Mustang Ventures, an affiliated China fund of Trident Capital Fund VI. In the past, Mr. Dixon has served as a director of a number of other corporations, many of which were acquired, including eGistics, Inc. which we acquired in July 2014. In addition to his board work for Trident, Mr. Dixon is Co-Chairman of the Advisory Committee of the Princeton University School of Engineering and Applied Sciences. Mr. Dixon also serves on the Advisory Board of the Harvard Kennedy School Center for Public Leadership. From 1988 to 1993, Mr. Dixon was Co-President of Partech International, a private equity fund associated with Banque Paribas. Prior to Partech, he was a Managing Director of Alex. Brown & Sons. Earlier in his career, Mr. Dixon was a Vice President of Morgan Stanley & Co. and a Senior Account Officer at Citibank, N.A. Raised in New Jersey, Mr. Dixon earned his B.S.E. from Princeton University and his M.B.A. from Stanford Graduate School of Business.

Brendan Reidy August 31, 2016 Brendan Reidy assumed the position of Chief Executive Officer of the Company in August, 2016. Mr. Reidy is a seasoned executive with a proven track record of driving rapid growth and increased shareholders' value within the software as a service ("SaaS") industry. Mr. Reidy most recently served as President, Chief Operating Officer and Chief Technology Officer of XRS Corporation. Under Mr. Reidy's leadership, XRS achieved a nearly twelvefold increase in valuation leading to the sale of XRS at a premium. In parallel, Mr. Reidy served as a member of the board of directors of eGistics for ten years prior to our acquisition of the company. Previously Mr. Reidy was Chairman, President and CEO of Clarus Systems, Inc. In addition, Mr. Reidy also served as a Venture Partner at Trident Capital, and at various times served on the boards of four Trident portfolio companies and held two full-time positions with portfolio companies. He earned an M.B.A. from The Wharton School, University of Pennsylvania, and a B.A. from Stanford University.

Patti Barton was appointed Acting Chief Financial Officer in 2017. Patti has been with Top Image Systems since 2015, having previously served as Vice President – Global Finance based in our US Headquarters. Patti has extensive experience in leading organizations to improved financial strength and increased shareholder value. Patti seasoned accounting executive with broad experience in financial leadership. Before joining Top Image Systems, Ms. Barton served in financial leadership roles Pulte Homes, Fannie Mae and Inland Investments. Ms. Barton began her career with eight years with KMPG and is a licensed CPA. Ms. Barton earned a B.B.A. from the University of Texas at Arlington College of Business.

Martin Hale founded Hale Capital Partners in 2007. Prior to that, Mr. Hale was a founding member of Pequot Ventures (now known as FirstMark Capital) where he served as a member of the General Partner. From 2002 to 2007, Mr. Hale was a Managing Director and a Member of the Operating & Investment Committees helping to lead 7 funds with approximately \$2.2 billion under management. Prior investments included Cobalt Networks (IPO, sold to Sun Microsystems for \$2 billion), Flarion Technologies (sold to Qualcomm for \$850 million), Celiant Corporation (sold to Andrew Corp. for more than \$500 million) and Analex Corporation (sold to QinetiQ for \$188 million). Prior to Pequot Ventures Mr. Hale was an Associate at Geocapital Partners and an Analyst at Broadview International. He received his B.A. cum laude from Yale University.

Izhak Nakar founded the Company in 1991, and served as our Chairman of the Board and CEO from inception until 2001. In 2001 – 2009, Mr. Nakar served as a Director. From 2009 to December 31, 2016, Mr. Nakar has served as the Active Chairman of the Board. On December 31, 2016, Mr. Nakar ceased being the Active Chairman of the Board, but continues as a Director, Until June 30, 2017, he will continue supplying certain services to the Company that he supplied as Active Chairman. Mr. Nakar has co-founded several technology companies including us and TopGuard (acquired by Elron Software NASDAQ:ELRN), e-Mobilis, Momsense and has founded Anir Vision and NIR 4 YOU Technology. Mr. Nakar served in the Israeli Air Force from 1970 to 1987, where he led various large-scale, highly technical development projects, including leading a development team that worked in cooperation with the U.S. Air Force. He received his B.Sc. in Computer Science from Bar Ilan University in 1982, and an MBA from Bar Ilan University in 1984. Mr. Nakar is a recipient of the “Israel Defense Award,” bestowed annually by the President of Israel, for the development of high-tech systems in the field of intelligence for the Israeli Defense Forces. He also received the “Man of the Year Award” in Business and Management (‘95-’96) in recognition of his business accomplishments and contributions to the growth and development of Israeli high-tech companies. In addition, in 2004, Mr. Nakar was elected as a member of the Board of Israel-Japan chamber of Commerce.

Ido Schechter served as our CEO from January 2002 through December 2013, and has been a director since December 2004. From January 2001 until he became CEO, Dr. Schechter was Vice President of TIS’ ASP², our initiative to offer data collection services via the Internet, using the eFLOW® platform solution. Prior to that Dr. Schechter was TIS’s Vice President of Sales from August 1996. From January 1995 until August 1996, Dr. Schechter served as General Manager of Super Image, a former affiliate of ours, which operated a form processing service bureau. From August 1993 to December 1994, Dr. Schechter oversaw the start-up of automatic form processing services at Israel Credit Cards, Ltd. From 1991 to 1993, Dr. Schechter was a research scientist at the Horticultural Research Institute of Ontario, Canada. Dr. Schechter is the recipient of eight Honors and Scholarships, has published or presented more than twenty-five articles and is a Captain in the Israeli Air Force. Dr. Schechter received his Ph.D. and M.Sc. in Plant Physiology from the University of Guelph in Ontario, Canada and his B.Sc. from the Hebrew University in Israel.

Osnat Segev-Harel was elected to serve as an external director in December, 2011 and was re-elected for a three-year term in December, 2014. Since November 10, 2016, she serves as a director. Ms. Segev-Harel has extensive experience of over 15 years in business development for high-tech companies. Ms. Segev-Harel is currently serves as a go to market consultant for early stage high tech companies. Until December 2013 Ms. Segev-Harel served as CMO and VP of business development for Sapiens International Corporation N.V. From 2005 through 2009 Ms. Segev-Harel served as a director of sales strategy and planning and as director of business development in NICE Actimize Inc. in New York, in which she has acquired a deep knowledge of the global banking industry in general and in North America in particular From 1995 through 2005 she served as business development executive in IBM, Israel,

including as an account manager in IBM's Banking Division. Prior to that, between 1988 and 1994 Ms. Segev-Harel was a User Interface project leader in Digital Equipment Corporations, Israel. Ms. Segev-Harel holds a Practical Engineering degree from the Hadassah College in Jerusalem, a B.Sc. in Futurism from the State University of New York and an MBA from Derby University majoring in Strategy. Ms. Segev-Harel has completed a Directors Certification Program at Bar Ilan University. Ms. Segev-Harel possesses professional competence as required by the Companies Law and regulations deriving thereof.

45

The foregoing information is based upon data provided to us by the relevant director or senior management member.

The Company is not aware of any familial relationships between any of the persons named above.

Compensation

The aggregate direct remuneration paid or payable to all persons who served in the capacity of executive officer during 2017 was approximately \$959,000, including approximately \$137,000, which was set aside for pension and retirement benefits and including amounts expended by us for automobiles made available to our executive officers.

Our agreement with Mr. Reidy, the Chief Executive Officer of the Company, provides for a base salary of \$0.3 million per year and for, pension, vacation or similar benefits. During 2017 Mr. Reidy was paid \$0.3 million.

Mr. Reidy is entitled to receive a bonus amount of \$0.2 million per annum, based on achievement of performance goals set by the Board of Directors. During 2017 no bonus payments were made.

In 2016, Mr. Reidy was awarded options to purchase 563,654 ordinary shares of the Company and additional 563,654 RSUs. The exercise price per share of the options is \$1.66. One third of the options and RSUs vested on August 23, 2017, and the remaining half will vest in equal monthly amounts, over a period of the following 24 months.

The total amount paid or payable to our directors, for 2017 was \$0.2 million. As of March 31, 2018, options to purchase 1,694,963 of our ordinary shares were held by certain executive officers and directors (consisting of 12 persons). Options with respect to 885,637 of such shares are currently exercisable or will become exercisable within 60 days of March 31, 2018. (See "Share Ownership.")

The compensation of our directors for 2017 (approved by our Compensation Committee and by our Board of Directors) was as follows: Each of Mr. Don Dixon, Mr. Izhak Nakar, Mr. Martin Hale, Ms. Osnat Segev-Harel and Dr. Ido Schechter received compensation for his or her service, in the amount of NIS 49,875 (approximately \$13,000) per year and an amount of NIS 3,330 (approximately \$870) for each meeting of the Board of Directors or any committee in which they participate.

In 2016, the Company reduced the exercise price on certain options in order to maintain incentive.

For further details about Mr. Nakar's compensation see "Related Party Transactions".

Committees of the Board

Audit Committee

Our audit committee is comprised of Donald Dixon, Martin Hale and Osnat Segev-Harel. The Companies Law requires that public companies appoint an audit committee. The responsibilities of the audit committee include: identifying defects or irregularities in the management of the company's business, deciding if certain actions are material in the context of conflicts of interest or extraordinary in the context of transactions with related parties and approving conflicts of interest and related party transactions, determining whether certain transactions with controlling shareholders require a competitive process or the process for approval of non-insignificant transactions, reviewing and suggesting changes to the internal auditor work plan, examining our internal auditing arrangements and the functioning of the internal auditor and determining arrangements as to treatment of complaints by our employees regarding defects in the management of the company's business and the protections to be given to such employees. In addition, as described under Item 16, the audit committee is responsible for the approval of all audit and non-audit services provided to the Company by Ernst and Young and for overseeing the qualifications, independence, appointment, compensation and performance of the Company's independent auditors. The audit committee operates

under a charter adopted by our Board of Directors and which is on display on our website at <http://www.topimagesystems.com>. Donald Dixon is the chairman of our audit committee. Furthermore, as required by NASDAQ rules all the members of our audit committee are independent, see “Directors, Senior Management and Employees- Independent Directors”.

NASDAQ rule 5605(c)(3) provides that an audit committee must have at least one member who has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities. The Board of Directors has determined that Osnat Segev-Harel meets those requirements.

Compensation Committee

Our compensation committee is comprised of Donald Dixon, Martin Hale and Osnat Segev-Harel. Osnat Segev-Harel is the chairperson. The Companies Law requires public companies to appoint a compensation committee. The responsibilities of the compensation committee under the Companies Law include: making recommendations to the Board of Directors with respect to our Compensation Policy and its extensions for additional periods, periodically reviewing the implementation of the Compensation Policy and providing the Board of Directors with recommendations with respect to any amendments or updates of it, approving transactions and arrangements with respect to the Terms of Office and Employment of office holders exempting a transaction with a candidate for chief executive officer from shareholder approval. The compensation committee also oversees the administration of the Company's various compensation plans and arrangements, in particular, the incentive compensation, deferred compensation and equity based plans of the Company (and to the extent appropriate, the subsidiaries of the Company) and assists the Board in fulfilling its responsibilities relating to the compensation of directors, the chief executive officer and other office holders of the Company. Furthermore, as required by NASDAQ rules all the members of our compensation committee are independent, see "Directors, Senior Management and Employees- Independent Directors".

Independent Directors

As a foreign private issuer, the Company follows the rules of the State of Israel in connection with the nomination of directors and the composition of its audit committee and compensation committee. Those rules are described under the rubrics "Audit Committee" (page 50), "Compensation Committee" and "Independent Directors" (page 51) and "External Directors" (page 60) in the Company's Form 20-F filed on April 15, 2016 (available for viewing at <https://www.sec.gov/Archives/edgar/data/1021991/000117891315001250/zk1516580.htm>).

On April 17, 2016, Israel adopted Regulation 5D of the Companies Regulations (Relief for Companies with Shares Registered for Trading Outside of Israel), 5760-2000 (the "Relief Regulations"). That regulation provided that, if shares of a company are registered for trading on a stock exchange listed in Regulation 5A(3) of the Relief Regulations (NASDAQ is so listed), the Company has no controlling shareholder as defined in the Companies Law, the Company fulfills the laws that apply to companies registered in the country of the stock exchange, with regard to the appointment of independent directors and the composition of audit committees and compensation committees, the company may elect not to be bound by the provisions of the Companies Law that require the appointment of external directors and their service on its audit and compensation committees. Even if a company so elects, it may not have a board of directors composed only of the members of one sex. A company that so elects is entitled to stipulate that the persons serving as external directors as of the time of the election may continue to serve as (non-external) directors until the earlier of (i) the end of the period for which each was elected or (ii) the second annual general meeting following the date of this resolution.

On November 10, 2016, the Company's Board of Directors determined that the Company met the requirements under regulation 5D of the Relief Regulations and elected not to be bound by the provisions of the Companies Law that require the appointment of external directors and their service on its audit and compensation committees. The Company further resolved that its external directors who were serving as of November 10, 2016 (Osnat Segev-Harel and Asael Karfiol) would continue to serve as directors until the earlier of (i) the end of the period for which each was elected or (ii) the second annual general meeting following the date of this resolution. Asael Karfiol has since ceased to be a director.

There are no requirements under Israeli law or regulations for the formation of a nomination committee nor regarding the general procedure for nominating directors for their terms in publicly traded companies.

Employees

The following table presents the number of our employees categorized by geographic location:

Location	No. of Employees as of December 31,		
	2015	2016	2017
Israel	43	37	26
Germany and rest of Europe	76	64	60
Japan	7	7	7
USA & Latin America	65	61	58
United Kingdom	13	12	9
Singapore and Hong Kong	29	25	19
Australia	7	7	6
Total	240	213	185

The following table presents the number of our employees categorized by activity:

	No. of Employees as of December 31,		
	2015	2016	2017
Professional services	119	106	104
Research and development	41	37	34
Sales and marketing	49	37	27
Operations and administrations	31	33	20
Total	240	213	185

We have never experienced any strikes or work stoppages. Substantially all of our employees have employment agreements and none are represented by a labor union.

We are subject to labor laws and regulations in Israel and in other countries where our employees are located. Although our Israeli employees are not parties to any collective bargaining agreement, we are subject to certain provisions of collective bargaining agreements that are applicable to our Israeli employees by virtue of expansion orders of the Israeli Ministry of Industry, Commerce and Labor. Israeli labor laws and the laws of other countries where our employees are located may differ materially from U.S. labor laws and, in some cases, impose material obligations on us (such as requirements to pay overtime, minimum wages, procedures for dismissal, severance pay or obligatory pensions and mandatory cost of living increases).

Share Ownership

Board of Directors, Senior Management and Certain Employees

Izhak Nakar, who served as the Active Chairman of our Board of Directors through December 2016 and who continues to serve as a director, beneficially owned 1,911,659 ordinary shares representing approximately 10.5% of the Company's issued and outstanding share capital, as of March 31, 2018. Ido Schechter, our former Chief Executive Officer and member of the board, beneficially owned 205,075 ordinary shares representing approximately 1.1% of the Company's issued and outstanding share capital, as of March 31, 2018. All other directors and executive officers each beneficially owned 1.6 % of the Company's shares. The following table sets forth information regarding options held by our directors and officers currently exercisable or exercisable within 60 days as of March 31, 2018. Ordinary shares subject to these options are deemed to be outstanding for the purpose of computing the ownership percentage set forth above of the person holding these options, but are not deemed to be outstanding for the purpose of computing the ownership percentage of any other person.

Name	Ordinary Shares		
	Underlying Options and RSU's	Expiration Dates	Exercise Prices (\$/share)
Options			
Izhak Nakar	305,000	2019 – 2027	\$1.29 - \$3.86
Ido Schechter	180,000	2021 – 2027	\$1.29 - \$3.86
Brendan Reidy	563,654	2026	\$1.66
Don Dixon	50,000	2025-2027	\$1.29 - \$3.30
Patti Barton	29,833	2025-2026	1.26-3.42
All other directors and officers as a group	126,335	2021 – 2025	\$2.11 - \$6.04
RSU's			
Brendan Reidy	30,336	2026	-

None of the ordinary shares beneficially owned by any of the directors or executive officers of the Company has any voting rights which are different than the voting rights held by all other holders of ordinary shares.

Stock Options

In order to attract, retain and motivate employees (including officers) who perform services for or on our behalf, we maintain three Employee Share Option Plans, one established in 1996 ("ESOP 1996"), the second in 2000 ("ESOP 2000") and the third in 2003 ("ESOP 2003"). Upon adoption of ESOP 2003, all shares previously available for grant under ESOP 1996 and ESOP 2000 that were not the subject of outstanding options were transferred to ESOP 2003 and are subject to the terms of ESOP 2003. Further, all options under such old plans that expire prior to their exercise according to the conditions detailed therein will be transferred into the new plan. On August 29, 2013, our Board of Directors, based on the recommendation of our compensation committee of the same day, resolved to amend and restate ESOP 2003 ("Amended ESOP 2003"). Those decisions were approved by the shareholders on October 15, 2013. On December 23, 2016, the shareholders approved the 2016 Israeli Incentive Plan (the "2016 Plan"), which will govern options awarded after such date. While the 2016 Plan retains most of the terms and conditions of the Amended ESOP 2003, it incorporates changes, inter alia, with regard to ability to issue RSUs. We filed the necessary documents with the Israeli tax authorities for the approval of the 2016 Plan on January 4, 2017 and the Company is entitled to award options under it 30 days after the filing. As a result, Israeli grantees are eligible for certain benefits under Section 102 of the Israeli Income Tax Ordinance (New Version) 1961. On June 15, 2016, upon recommendation of the Compensation Committee, the Board approved a voluntary repricing plan by which option holders could elect to exchange their current options for new options at a ratio of 1:2 (1 new option for every 2 options currently held by the option holder). The exercise price for the new options was set at \$2.11 All other terms of the options remained unchanged. Implementation of the repricing plan with regard to the options held by directors and the

CEO were approved by the shareholders on December 23, 2016. In October 2017 the stockholders approved a US sub-plan to the Company's 2016 Israeli Incentive Plan. As of March 31, 2018, options to purchase an aggregate of 3,119,293 ordinary shares were outstanding. The outstanding options are exercisable at exercise prices between \$1.30 and \$6.04. In addition, 407,725 RSUs were outstanding as of March 31, 2018.

Further, upon the recommendation of the Compensation Committee, the Board decided on June 15, 2016 to allow executives eligible for performance-based bonuses to elect to receive bonuses in whole or in part as restricted share units ("RSUs") instead of awarding full cash bonuses. The RSUs are to be issued at par value to members of the executive management who are subject to the compensation policy, who have met certain targets set by the Board. Each grant of RSUs will vest in two equal parts, subject to the continued employment of the grantee. As of March 31, 2018, a total of 407,725 RSUs had been issued to several officers and were outstanding.

On August 3, 2016, the board of directors approved the repricing of all unvested options as of that date, to an exercise price of \$ 2.11. The number of options and the vesting terms for the repriced options remained unchanged. Total of 401,414 unvested options were repriced during 2016 based on this plan.

In addition to shares reserved in the event of the exercise of the outstanding options, 1,722,279 shares are reserved in the event of the issue of additional options or RSUs.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Major Shareholders

The following table sets forth certain information regarding the beneficial ownership of our outstanding ordinary shares as of March 31, 2018, for each person whom we know (based on filings with the SEC) beneficially owns five percent or more of the outstanding ordinary shares.

Beneficial ownership of shares is determined under SEC, and generally includes any shares over which a person exercises sole or shared voting or investment power. The number of shares indicated as "Beneficially Owned" in the following table includes the number of shares underlying options or warrants that are currently exercisable or may be exercised in 60 days. Ordinary shares subject to these options are deemed to be outstanding for the purpose of computing the ownership percentage of the person holding these options, but are not deemed to be outstanding for the purpose of computing the ownership percentage of any other person. Applicable percentages are based on 18,251,722 ordinary shares outstanding as of March 31, 2018.

Name	Number of Shares		Percentage of Shares	
	Beneficially Owned			
Izhak Nakar (1)	1,911,659	10.5	%	
Entities Associated with Trident Capital, Inc. (2)	2,346,707	13.0	%	

(1) Mr. Nakar's beneficially owned shares includes 1,562,735 ordinary shares held by Nir 4 You Technologies Ltd., which is owned by Mr. Nakar.

(2) The information is based upon the recent Schedule 13G filed with the SEC by Trident Capital Management V LLC on February 17, 2015. Consists of (i) 2,102,267 held of record by Trident Capital Fund-V, L.P., a Delaware limited partnership, (ii) 60,846 held of record by Trident Capital Fund-V Principals Fund, L.P., a Delaware limited partnership, (iii) 12,218 held of record by Trident Capital Fund-V Affiliates Fund, L.P., a Delaware limited partnership, (iv) 11,659 held of record by Trident Capital Fund-V Affiliates Fund (Q), L.P., a Delaware limited partnership, and (v) 159,717 held of record by Trident Capital Parallel Fund-V, C.V., a partnership organized under the laws of the Netherland. Trident Capital Management-V, L.L.C, a Delaware limited liability company ("TCM-V"), is the sole general partner of Trident Capital Fund-V, L.P., Trident Capital Fund-V Affiliates Fund, L.P., Trident Capital Fund-V Affiliates Fund (Q), L.P. and Trident Capital Fund V Principals Fund, L.P. TCM-V is the sole investment general partner of Trident Capital Parallel Fund-V, C.V. The members of TCM-V are Donald

R. Dixon, Peter T. Meekin, John H. Moragne and Robert C. McCormack (collectively, the “Managers”), together in the case of certain such individuals with their respective family planning vehicles as reported as of July 31, 2014. The Managers of TCM-V share voting and investment power with respect to the shares held by each fund.

Significant Changes in Percentage Ownership

In February 2014, we closed on an underwritten public offering of 3,162,500 of our ordinary shares at \$4.75 per share for gross proceeds of \$15.0 million. The aggregate amount of ordinary shares sold reflects the exercise in full by the underwriters of their option to purchase up to 412,500 additional ordinary shares to cover over-allotments. We received net proceeds of approximately \$13.7 million from the sale of ordinary shares, after deducting the underwriters' discounts and other offering expenses. The net proceeds from the offering have been and will be used for general corporate purposes, including acquisitions. Canaccord Genuity Inc. acted as the sole book-running manager for the offering, and Roth Capital Partners and The Benchmark Company, LLC acted as co-managers.

As of March 31, 2018, 18,251,722 ordinary shares of Company were issued and outstanding. The Company believes that, as of March 31, 2018, there were 21 shareholders of record of the Ordinary Shares in the United States, who, collectively held as of that date a total of 16,416,923 ordinary shares, or 89.9% of the Company's total outstanding ordinary shares.

Related Party Transactions

In May 2018, we entered into the Term Sheet with Hale Capital Partners. Hale Capital Partners is an affiliate of Martin Hale.

In December 2016, we borrowed \$5 million from HCP-FVE, LLC. HCP-FVE is an affiliate of Martin Hale.

The Company has not yet determined if it will draw on the Credit Facility. If the Company draws on the Credit Facility, there will be changes made to the Convertible Note. If the Company elects not to withdraw funds out of the Credit Facility, it will be obligated to pay to Hale Capital Partners, LP a break up fee of equal to three percent (3%) of the Credit Facility.

Our agreement with Mr. Izhak Nakar provided that in consideration for his services to the Company worldwide, Mr. Nakar was entitled to compensation in the amount of \$28.1 thousand plus VAT per month. This amount was reduced to \$24.8 thousand plus VAT per month during the months of April to December 2016.

During 2017 and 2016, we paid Mr. Nakar \$197 thousand and \$359 thousand in cash compensation. That agreement ceased on June 30, 2017.

In addition, during 2015, Mr. Nakar was awarded options to purchase 100,000 ordinary shares of the Company, vesting in two equal parts such that 50% vested on December 31, 2015 and the remainder vested on December 31, 2016. The exercise price per share of the Options was \$3.30. 50,000 options related to this grant were repriced during a repricing process in 2016, the repriced share price was \$2.11. Pursuant to our agreements with Mr. Nakar, Mr. Nakar was entitled to receive a payment equal to 4.25% of our EBITDA for the year ended December 31, 2016, if we met certain revenue and EBITDA targets set by the Board.

The terms of Mr. Nakar's compensation for 2016 other than the options and conditional bonus were approved in accordance with Israeli law as it existed prior to the 2012 Amendment (see "Approval of Terms of Office and Employment"). Under the transitional provisions of that amendment, the approval remains effective. The conditional bonus was approved by the Compensation Committee and then the Board of Directors on May 17, 2016 and then by the Shareholders at the Company's annual general meeting on December 23, 2016. No payments have been made related to the conditional bonus.

From time to time, as new members join our Board of Directors, they become parties to our letter of indemnification to be given to our directors and officers. The letter was approved by our shareholders at a shareholders meeting held

on November 15, 2005 and amended at a shareholders meeting held on December 22, 2011. The aggregate indemnification amount that the Company will pay to all its officers and directors pursuant to these letters of indemnification shall not exceed \$20,000,000.

ITEM 8. FINANCIAL INFORMATION

Consolidated statements and other financial information

Consolidated Financial Statements

See Item 18.

Other Financial Information

The amount of export revenues constitutes a significant portion of our total revenues. The following is a table giving details of our export revenues, as well as the breakdown of revenues between products and services.

	2015	2016	2017		
	\$ Thousands				
<u>Export Revenues</u>					
Export Revenues	33,063	30,993	29,135		
Total Revenues	33,791	31,635	29,663		
Percentage of Total Revenues	97.8 %	98.0 %	98.2 %		

Breakdown of Revenues

License Revenues	23 %	19 %	18 %		
Service Revenues	77 %	81 %	82 %		

Legal Proceedings

During 2016, a third party that the Company works with sued the Company for alleged comments that they believe the Company made that could lead to a breach of contract. The Company has filed a counter-suit. In March 2018 the parties settled all claims in exchange for a payment of approximately \$389 thousand, which was accrued in the Company's financial statements as of December 31, 2017. Subsequent to December 31, 2017 we paid the third party \$384 thousand in relation to the settlement of all claims. This amount was accrued in the financial statements as of December 31, 2017.

In August 2017, one of the Company's customers claimed for damages for non-contractual fulfilment. The Company and its attorneys cannot yet assess the possible outcome.

In October 2017 a former executive raised claims regarding his termination from employment. In December 2017 the parties settled all claims in exchange for a payments totaling approximately \$569 thousand to be throughout 2018, which was accrued in the Company's financial statements as of December 31, 2017.

In December 2017, one of the Company's customers claimed for damages, for non-contractual fulfilment. The Company and its attorneys cannot yet assess the possible outcome.

Subsequent to December 31, 2017, in March 2018, one of the Company's customers claimed for alleged breach of maintenance contact by the Company. The Company and its attorneys cannot yet assess the possible outcome.

Dividend Policy

To date, we have not paid any dividends on our ordinary shares. The payment of dividends in the future, if any, is within the discretion of the Board of Directors and will depend upon our earnings, our capital requirements and

financial condition and other relevant factors. We may not declare or pay any dividends on ordinary shares in the future.

The Company has issued the Convertible Note to HCP FVE. The Convertible Note is to be converted to Series A Preferred Shares if and when shareholder approval for articles authorizing such shares is obtained. The preferred shares, if issued, will be entitled in certain circumstances to receive dividends at the prime rate plus 2.5% - 3%. Upon withdrawal from the Credit Facility, the Convertible Note, plus accrued interest, will be exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0% and the convertibility to convertible preferred shares will be cancelled.

We have the status of an "Approved Enterprise" and "Benefited Enterprise" under the Law for the Encouragement of Capital Investments, 1959, and as amended, under which we may take advantage of certain tax exemptions. If we distribute a cash dividend from income which derived from the Approved and Benefited Enterprise during the tax exemption period, we would have to pay corporate tax at a rate of up to 25% (depending on the foreign investments in the Company) on the amount equal to the amount distributed and on the amount of corporate tax which would have been due in the absence of the tax exemption, in addition to withholding tax on such dividends paid. For further description of the conditions limiting our ability to declare and pay dividends see "Israeli Taxation, Foreign Exchange Regulation and Investment Programs".

The distribution of dividends may also be limited by the Companies Law, which permits the distribution of dividends only out of retained earnings or earnings derived over the two most recent fiscal years, whichever is higher, provided that there is no reasonable concern that payment of a dividend will prevent a company from satisfying its existing and foreseeable obligations as they become due. Our articles of association provide that dividends will be paid at the discretion of, and upon resolution by, our Board of Directors however, the Board of Directors at its discretion, may transfer the decision in this matter to the general meeting.

Significant Changes.

None.

ITEM 9. LISTING

Offer and Listing Details.

Since November 1996, our ordinary shares have been quoted on the NASDAQ. Since April 29, 1999, the symbol for the ordinary shares has been "TISA."

The following table sets forth, for the periods indicated, the high and low closing prices of our ordinary shares, as reported on the NASDAQ.

Stock price history

The annual high and low market prices (in USD) for the ordinary shares for the five most recent full financial years are set forth below:

Year Ended	Price
December 31, 2017	Hi \$1.63 Lo .98
December 31, 2016	Hi 2.98 Lo 1.22
December 31, 2015	Hi 4.32 Lo 2.83
December 31, 2014	Hi 5.88 Lo 3.29
December 31, 2013	Hi 6.04 Lo 2.66

The high and low market prices for the ordinary shares for each full financial quarter over the two most recent full financial years and any subsequent period are set forth below:

Quarter Ended	Price
December 31, 2017	Hi \$1.63 Lo .98
September 30, 2017	Hi 1.36 Lo 1.11
June 30, 2017	Hi 1.42 Lo 1.17
March 31, 2017	Hi 1.59 Lo 1.22
December 31, 2016	Hi \$2.33 Lo 1.22
September 30, 2016	Hi 2.39 Lo 1.76
June 30, 2016	Hi 2.44 Lo 1.42
March 31, 2016	Hi 2.98 Lo 1.52

For the most recent six months, the high and low market prices of the ordinary shares for each month are set forth below:

Month Ended	Price
March 31, 2018	Hi \$1.06 Lo .96
February 28, 2018	Hi 1.12 Lo .99
January 31, 2018	Hi 1.17 Lo 1.07
December 31, 2017	Hi 1.28 Lo .98
November 30, 2017	Hi 1.28 Lo 1.03
October 31, 2017	Hi 1.63 Lo 1.25

Markets

Our ordinary shares were dual-listed on the TASE on December 3, 2006, in addition to being listed on the NASDAQ. Effective October 31, 2014, we voluntarily delisted from TASE.

ITEM 10. ADDITIONAL INFORMATION

Memorandum and Articles of Association

General

TIS is registered with the Israel Registrar of Companies. The registration number issued to TIS by the Registrar of Companies is 52-004294-6. The objectives for which we were founded are set out in Section 2 of the Memorandum of Association as follows: “The Company is permitted to deal with any activity that is meant to advance the interests of the Company and to act in any field which the Company’s management believes is beneficial to the Company.” At our December 22, 2011 shareholders meeting, we adopted a new set of Articles of Association to accommodate changes that had been made in the Companies Law and in the Israel Securities Law, 1968-5728 (the Securities Law). At our October 19, 2017 shareholders meeting, the shareholders approved an amended and restated Articles of Association which provide for among other things, (i) HCP FVE’s right to appoint a member of the Board of Directors and (ii) the creation of a class of preferred stock into which HCP FVE’s Convertible Notes will be convertible.

Directors and other Office Holders

General

A director's ability to vote on a proposal, arrangement or contract in which the director is materially interested is codified, along with the fiduciary duties of all "office holders," in the Companies Law. Under the Companies Law, the term "office holders," is defined to mean, a director, chief executive officer, chief business manager, deputy chief executive officer, vice chief executive officer, any person filling any of those roles in a company even if his title is different and any other manager directly subordinate to the chief executive officer. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care includes avoiding negligent acts and acting skillfully as a reasonable office holder would act. The duty of loyalty includes avoiding any conflict of interest between the office holder's position in the company and his personal affairs, avoiding any competition with the company, avoiding exploiting any business opportunity of the company in order to receive personal advantage for himself or others, and revealing to the company any information or documents relating to the company's affairs which the office holder has received due to his position as an office holder of the company.

The Israeli Companies Law requires that an office holder promptly disclose any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company.

In the case of a transaction in which an office holder (other than a director or the CEO) has a personal interest, that is not an extraordinary transaction, as defined under Israeli law, and after the office holder complies with the above disclosure requirement, only board approval is required. Members of the board having a personal interest should not be present at the vote or exercise their vote unless a majority of the board has a personal interest. The transaction must not be adverse to the company's interest. If such transaction is an extraordinary transaction or if we intend to provide an undertaking to indemnify, exempt or insure an office holder, with regard to their duties, then, in addition to any approval required by the Board of Directors or by any other organ of the company according to its Articles of Association, it also must be approved by the audit committee or compensation committee (depending on the nature of the transaction) prior to the approval by the Board of Directors, and, under specified circumstances, by a meeting of the shareholders. .

Arrangements regarding the compensation of our directors (whether regarding in their capacity as directors or regarding the provision of other services) or of our CEO require compensation committee, Board of Directors and shareholder approval, in some cases with special majorities.

Alternate Directors

Under the Companies Law, the Articles of Association of a company may entitle a director to appoint another person to serve as an alternate director. Our Articles entitle our directors by written notice to us to make such an appointment and to cancel any such appointment. Our Articles also provide that any person may act as an alternate director. The Companies Law prohibits incumbent directors from acting as alternate directors and a single person from acting as an alternate director for more than one incumbent director.

The term of appointment of an alternate director may be for one meeting of the Board of Directors or for a specified period or until notice is given of the cancellation of the appointment. To our knowledge, no director currently intends to appoint any other person as an alternate director, except if the director is unable to attend a meeting of the Board of Directors.

Internal Auditor and Certified Public Accountant

Under the Companies Law, the Board of Directors must appoint an internal auditor, nominated by the Audit Committee. The role of the internal auditor is to examine, among other matters, whether the company's actions comply with the law and orderly business procedure. Under the Companies Law, the internal auditor may be an employee of the company but not an office holder (as defined above), nor an affiliate, nor a relative of an office holder or affiliate, and he or she may not be the company's independent accountant or its representative. In addition, the internal auditor may not be a person who holds 5% or more of the company's outstanding share capital or voting rights, or a person who has the right to appoint one or more directors or the general manager. The Company's internal auditor is Mr. Doron Cohen of Fahn Kanne Control Management Ltd., a member firm of Grant Thornton International.

In addition, under the Companies Law, all companies must appoint a certified public accountant to audit the company's financial statements and to report to the chairman of the Board of Directors any material improprieties that it may discover with respect to the accounting control of the company. In our last shareholders meeting, held on October 19, 2017, we appointed Kost Forrer Gabbay and Kasierer, a member firm of Ernst & Young Global and certified public accountants in Israel, as our certified public accountant for auditing services, effective until the next shareholders meeting.

Indemnification of Directors and Officers

At a shareholders meeting held on December 22, 2011, following the amendment of the law in 2011, the shareholders approved the adoption of a new Articles of Association, which include, inter alia, an expansion of the insurance and indemnification given to office holders to the maximum extent permitted by law and in addition, the Shareholders approved the amendment of the indemnification letter currently in place with regard to the Company's directors and office holders. See "Major Shareholders and Related Party Transactions - Related Party Transactions."

Under the Companies Law, a company may indemnify an office holder against any monetary liability incurred in his or her capacity as an office holder whether imposed on him or her or incurred by him or her in favor of another person pursuant to a judgment, a settlement or an arbitrator's award approved by court. A company also can indemnify an office holder against reasonable litigation expenses including attorneys' fees, incurred, whether or not paid by him or her in his or her capacity as an office holder, in proceedings instituted against him or her by the company, on its behalf or by a third-party, in connection with criminal proceedings in which the office holder was acquitted, or as a result of a conviction for a crime that does not require proof of criminal intent, or in which an indictment was not brought against the office holder.

In addition, a company may indemnify an office holder against reasonable legal fees, including attorney's fees, incurred, whether or not paid by him or her in consequence of an investigation or proceeding instituted against him or her by an authority that is authorized to conduct such investigation or proceeding, and that was resolved without an indictment against him or her and without imposing on him or her financial obligation as an alternative of a criminal proceeding, or that was resolved without filing an indictment against him or her but with the imposition on him or her of a financial obligation as an alternative to a criminal proceeding in respect of an offense that does not require the proof of criminal intent.

A company may indemnify an office holder in respect of these liabilities either in advance of an event or following an event. If a company undertakes to indemnify an office holder in advance of an event, the indemnification, other than litigation expenses, must be limited to foreseeable events in light of the company's actual activities when the company undertook such indemnification, and reasonable amounts or standards, as determined by the Board of Directors.

A company may obtain insurance for an office holder against liabilities incurred in his or her capacity as an office holder. These liabilities include a breach of duty of care to the company or a third-party, including a breach arising out of negligent conduct of the office holder, a breach of duty of loyalty and any monetary liability imposed on the office holder in favor of a third-party. A company may also exculpate an office holder from a breach of duty of care in advance of that breach. Our Articles provide for exculpation both in advance or retroactively, to the extent permitted under Israeli law. A company may not exculpate an office holder from a breach of duty of loyalty towards the company, from a breach of duty of care concerning dividend distribution or a purchase of the company's shares by the company or other entities controlled by the company or from procedures according to chapters H3, H4 or I1 of the Securities Law .

Under the Companies Law, a company may indemnify or insure an office holder against a breach of duty of loyalty only to the extent that the office holder acted in good faith and had reasonable grounds to assume that the action would not prejudice the company. In addition, a company may not indemnify, insure or exculpate an office holder against a breach of duty of care if committed intentionally or recklessly (excluding mere negligence), or committed

with the intent to derive an unlawful personal gain, or against a fine or forfeit levied against the office holder in connection with a criminal offense. In addition a company may indemnify any person as permitted in Section 56H(b)(1) of the Securities Law.

At the shareholders meeting held on October 19, 2017, the shareholders approved entering into an indemnification agreement between the Company and each of the Company's current and future directors and CEOs in the form of indemnification agreement approved at such meeting. Currently, we hold an insurance policy for our office holders that provides coverage limited to \$20,000,000 in aggregate for the policy period ending on April 30, 2019.

Approval of Terms of Office and Employment

Any arrangement between a public company and an office holder of the company as to such office holder's terms of office and employment, including exemption and release of the office holder from liability for breach of his or her duty of care to the company, an undertaking to indemnify the office holder, post factum indemnification or insurance; any grant, payment, remuneration, compensation, or other benefit provided in connection with termination of service; and any benefit, other payment or undertaking to provide any payment as aforesaid ("Terms of Office and Employment"), now generally require the approval of the company's compensation committee and the Board of Directors and, with respect to directors and the chief executive officer, also the company's shareholders, sometimes with special majorities. Notwithstanding the above, the amendment of existing Terms of Office and Employment of office holders (other than directors and the CEO), requires the approval of the compensation committee only, if the committee determines that the amendment is not material in relation to its existing terms.

In addition, the Terms of Office and Employment of office holders must be in accordance with the terms of a compensation policy adopted by the Company (a "Compensation Policy"). Under the Companies Law, the Compensation Policy must be based on those considerations, must include those provisions and needs to reference those matters detailed in the Companies Law.. A Compensation Policy generally must be brought for approval again in accordance with the procedures of the Companies Law once every three years. On May 21, 2015 the Company's Board of Directors, based on the recommendation of its Compensation Committee of the same day, resolved to approve an amendment and restatement of the compensation policy in the form presented to the shareholders at the annual meeting held on December 28, 2015 (the "Compensation Policy"). The Board of Directors reaffirmed that approval on October 29, 2015. The shareholders did not approve the Compensation Policy with the requisite special majority. On November 10, 2016, in accordance with their powers under the Companies Law, the Compensation Committee and the Board of Directors decided to approve the Compensation Policy even though it had not been approved by the Shareholders.

Directors

Any arrangement between a company and a director as to his or her Terms of Office and Employment must be in line with the Compensation Policy and requires the approval of the compensation committee, the Board of Directors and the shareholders by a simple majority. On October 19, 2017, the shareholders approved option grants to each of the Company's directors along with an additional grant to Ms. Osnat Segev-Harel following the recommendation of the Compensation Committee and the Board of Directors on April 25, 2017 as Ms. Segev-Harel was unable to benefit from the Company's 2016 repricing plan of the options held by directors and the CEO (see "Share Ownership – Stock Options") since she served as an external director at that time.

Chief Executive Officer

Any arrangement between a company and its chief executive officer as to his or her Terms of Office and Employment must be in line with the Compensation Policy and requires the approval of the Compensation Committee, the Board of Directors and the company's shareholders by simple majority. The compensation committee approved the terms of the CEO's compensation as delineated in an offer letter previously signed with him on November 10, 2016 (effective retroactive as of August 23, 2016) and the Board of Directors approved those terms on the same day. The shareholders approved the terms on December 23, 2016.

Other Office Holders

Any arrangement between a company and an office holder (other than a director or the chief executive officer) as to his or her Terms of Office and Employment must be in line with the Compensation Policy and requires the approval of the Compensation Committee and the Board of Directors.

Rights, Preferences, Restrictions of Shares

Articles of Association

The following is a summary of the material provisions of our Amended and Restated Articles of Association approved by our shareholders on October 19, 2017 and related provisions of Israeli corporate law. For the complete text of our Amended and Restated Articles of Association, see “Item 19 – Exhibits.”

Description of shares

Our authorized share capital consists of NIS 5,000,000 divided into the following two classes of shares:

(i) 115,000,000 ordinary shares, NIS 0.04 nominal value (“ordinary shares”); and (ii) 10,000,000 Series A Preferred Shares, NIS 0.04 nominal value (“preferred shares”).

Description of Ordinary Shares

All of the issued and outstanding ordinary shares are validly issued, fully paid, and non-assessable. The ordinary shares do not have pre-emptive rights. Our articles of association and Israeli law do not restrict in any way the ownership or voting of our ordinary shares by non-residents of Israel, except with respect to citizens of countries that are in a state of war with Israel.

Subject to Israeli law, dividends may be declared by a company's Board of Directors, unless authority is provided in the company's articles of association to transfer such powers to the company's shareholders, who may then declare dividends following a recommendation by the directors. Our articles of association grant the board the power to transfer the final decision regarding dividends to the shareholders. In such event, the shareholders may only declare a dividend in an amount that is equal or less than that recommended by the directors or not to declare a dividend at all, despite a directors' recommendation, but may not declare dividend in an amount which is in excess of the amount recommended by the directors. The directors may invest or use otherwise for the company's benefit, any dividends that are not demanded within one year of their being declared. The directors shall pay such un-demanded dividends upon receipt of a valid demand; however the company is not liable to pay any interest on such un-demanded dividends. So long as any preferred shares are outstanding, the Company shall not pay or declare any dividend, or make any other distribution on the Ordinary Shares or any other securities of the Company, until all accrued and unpaid dividends on the preferred shares, and all other amounts due and owing in respect of the preferred shares, have been paid, in full. As of the date of this annual report, none of the preferred shares were issued and outstanding.

Each shareholder is entitled to one vote for each ordinary share held. Each director is elected to serve until the next annual general meeting of shareholders and until his or her successor has been elected. Our articles do not grant shareholders any rights to share in our profits other than through dividends. In the event that we go into liquidation, any surplus is distributed to the shareholders in proportion to the amount paid by each on account of the nominal value of the shares paid. No account is taken of any premiums paid in excess of the nominal value.

We may issue and redeem redeemable shares and redeemable warrants. There are no sinking fund provisions recorded in our Articles. The directors may only make calls upon shareholders in respect of sums unpaid on their shares. Our Articles contain no provisions which discriminate against any existing or future shareholder as a result of said shareholder holding a substantial number of shares.

According to our articles of association, any resolution on the change of the Company's share capital by way of the creation of new shares, or cancellation of unissued registered shares, with preferred or qualified rights is deemed a change of our articles of association and as such requires the vote of a simple majority of the shareholders participating in the general meeting, subject to those actions that require the special affirmative consent of HCP FVE or the director appointed on its behalf (see "Material Contracts" below for further information with respect to these protective provisions). If at any time our share capital is divided into different classes of shares, we may change the rights of shareholders by way of a resolution of the general meeting, subject to the consent of the shareholders of the class whose rights are being impaired by the proposed change.

Description of Preferred Shares

We have 10,000,000 preferred shares authorized. These preferred shares may be issued upon conversion of the Convertible Notes note issued to HCP FVE on December 5, 2016 (see "Recent Developments - Sale of Convertible Note to HCP-FVE, LLC"). The preferred shares bear a number of rights and preferences, including dividend rights, conversion rights, redemption rights, and liquidation preference as fully set forth in our amended and restated articles of association (see "Chapter K: Rights, Preferences and Privileges of the Series A Preferred Shares" to our amended and restated articles of association provided in "Item 19 – Exhibits – Exhibit 1.1" for a full description of these rights). Upon withdrawal from the Credit Facility (see "Recent Developments – Credit Facility"), the Convertible Note, plus accrued

interest, will be exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0% and the convertibility to convertible preferred shares will be cancelled.

Meetings of Shareholders

An annual general meeting must be held once in each year and not later than fifteen months after the preceding annual general meeting. All shareholders are entitled to attend and vote or vote by proxy at annual general meetings. Notice of annual general meetings may be sent by us by personal delivery, post, facsimile or telex to shareholders at the address recorded in our records. Any notice sent by post to a shareholder's address that is situated outside of Israel must be sent by airmail. Any general meeting that is not an annual general meeting is called an extraordinary general meeting. All shareholders are entitled to attend and vote or vote by proxy at extraordinary general meetings.

Our Board of Directors may convene an extraordinary general meeting when and as it sees fit. In addition the Board must, according to statute, convene an extraordinary general meeting if it receives a demand to do so from either (i) at least two directors, (ii) at least one quarter of the directors of the Board or (iii) one or more shareholders who hold (A) an aggregate of at least five percent of our issued share capital and one percent of all voting rights, or (B) at least five percent of all voting rights. Any demand by a person or persons, as described in (i), (ii) and/or (iii) of this paragraph, who wish to demand that an extraordinary general meeting be convened must be made in writing and sent to our registered office. The demand must detail the objects of the meeting and must be signed by all those making the demand.

Notice of an annual general meeting and of an extraordinary general meeting must be sent in advance to all shareholders recorded in our register of shareholders in accordance with the dates required according to the applicable law. Such notice must include the place, date and hour of the meeting, the agenda for the meeting, the proposed resolutions and instructions for proxy voting.

The determining date as to share ownership for purposes of attending and voting at a general meeting is as set forth in the decision to convene a general meeting but not earlier than 21 day before the scheduled general meeting date and not later than 4 days prior to such scheduled meeting date; Notwithstanding the foregoing, Israeli companies such as ours whose shares have been listed for trade both on the TASE and recognized foreign stock exchange, which issue proxy statements to their shareholders in conformity with the law of the country where such foreign exchange is located, are entitled to vary such determining date to not earlier than 40 days before the scheduled general meeting date and not later than 4 days prior to such scheduled meeting date, and are entitled to certain allowances as to issuing proxy statements to shareholders outside Israel, in accordance with the Companies Regulations (Allowances for Companies with Securities Listed on an Exchange Outside Israel), 2000.

Limitations of Shareholders

No limitations exist or are imposed by Israeli law or our constituent documents with regard to the right to own our shares, including any limitations upon the rights of non-resident or foreign shareholders to hold or exercise voting rights.

Limitations on Change of Control

There are no provisions in our Articles or other constituent documents other than as required by law that would have an effect of delaying, deferring or preventing a change in control of us.

Provisions Relating to Major Shareholders

We are required by law to maintain a separate register of shareholders that hold 5%, or more of either our issued shares or voting rights.

The Companies Law applies the same disclosure requirements to a controlling shareholder of a public company, which includes a shareholder that holds 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company, as it does to “office holders” in the context of a related party transaction. For the purposes of this definition, the law deems two or more shareholders who hold voting rights in the company and each of which has a personal interest in the approval of a transaction being brought to the company for approval, as jointly holding such shares. . Extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and agreements relating to employment and compensation terms of a controlling shareholder, require the approval of the audit committee or the compensation committee (depending on the nature of the transactions), the Board of Directors and the shareholders of the company.

Shareholder approval must either include majority of the shares held by disinterested shareholders who are present, in person or by proxy, at the meeting, or, alternatively, the total shareholdings of the disinterested shareholders who vote against the transaction must not represent more than 2% of the voting rights in the company. In addition, a private placement of securities that grants 20% or more of the actual voting rights in the company prior to such private placement, of which proceeds are not in cash or in registered securities or that is not in “market terms”, that will increase the relative holdings of a shareholder that holds 5% or more of the company’s outstanding share capital, assuming the exercise of all of the securities convertible into shares held by that person, or that will cause any person to become, as a result of the issuance, a holder of more than 5% of the company’s outstanding share capital, requires approval by the Board of Directors and then the shareholders of the company.

Under the Companies Law, a shareholder has a duty to act in good faith towards the company and the other shareholders and to refrain from abusing his power in the company, including, among other things, voting in the general meeting of shareholders on the following matters:

·any amendment to the Articles of Association;

- an increase of the company's authorized share capital;
- a merger; or
- approval of interested party transactions that require shareholder approval.

In addition, any controlling shareholder who can determine the outcome of a shareholder vote and any shareholder who, under a company's Articles of Association, can appoint or prevent the appointment of an office holder, is under a duty to act with fairness towards the company. The Companies Law does not describe the substance of this duty.

The Companies Law provides that in the event that a controlling shareholder breaches his duty of fairness then such breach shall be considered a breach of contract, *mutatis mutandis*, while taking into account the special position of such controlling shareholder within the company.

Pursuant to our amended and restated articles of association, HCP FVE is entitled to appoint a member to our Board of Directors for as long as HCP FVE holds at least 35% of the original aggregate principle amount of the Convertible Note or its preferred share equivalent, as the case may be. Such rights restrict the Company's ability to take certain actions (see "Material Contracts" below for further information with respect to these protective provisions).

Material Contracts

Other than as described below, neither we nor any of our subsidiaries has entered into any material contracts, other than contracts entered into in the ordinary course of business, during the two years immediately preceding publication of this document:

In May 2018, we entered into the Term Sheet) with Hale Capital Partners which provides for the secured Senior Loan of up to \$3 million as part of the Credit Facility that would include the existing Convertible Note held by an affiliate of Hale in an amount of \$5.6 million. The Senior Loan would include monthly repayments of \$50,000 in 2019 and \$100,000 from January 2020 through maturity (such amount to increase on the happening of certain events), an interest rate of Prime plus 5% payable monthly and a 36-month term. In connection with the Credit Facility we will issue 10-year warrants to purchase the number of our ordinary shares equal to 40% of the total Credit Facility divided by the market price. The warrants will have an exercise price equal to the market price of the ordinary shares plus 15%. The Credit Facility will be secured by the Company's assets and will be guaranteed by each of our subsidiaries, subject to certain limitations. The Senior Loan would be required to the prepaid on certain events and would be prepayable at the Company's option at a premium beginning one year following closing.

In December 2016, we borrowed \$5 million from HCP-FVE, LLC, an affiliate of Hale Capital Partners in exchange for a convertible promissory note (the "Convertible Note") which bears interest at the prime rate plus 2.5% (if paid in cash) or 3% (if the interest capitalized) per annum and matures (if not converted prior) in December 2020. As of March 31, 2018, the principal amount of the Convertible Note is convertible into 3,094,998 of our ordinary shares. The transaction contemplates revising our Articles of Association to create a new class of Company preferred stock. Our stockholders approved the revised Articles of Association during the annual shareholders meeting in October 2017. As of May 15, 2018, the Convertible Note has not been converted into preferred shares. If issued, the preferred shares will also be convertible into our ordinary shares at the same conversion price. Upon withdrawal of the Credit Facility, the Convertible Note, plus accrued interest, will be exchanged for secured notes that will be junior to the Senior Loan with an interest rate of Prime plus 4.0% and the convertibility to convertible preferred shares will be cancelled.

The transaction contemplates revising our Articles of Association to create a new class of Company preferred stock. The stockholders approved the revised Articles of Association during the annual shareholders meeting in October 2017. The preferred stock will also be convertible into our ordinary shares at the same conversion price.

The Convertible Note bears interest at the prime rate plus 2.5% (if paid in cash), or 3% (if capitalized) per annum and the preferred stock, if issued, will be entitled to dividends at the same rate in cash or as elected bonus shares if certain conditions are met. If not converted, the convertible Note will mature in December 2020.

The Convertible Note and preferred stock have certain approval rights and provide HCP FVE with the right to appoint a member to our Board of Directors. The approval rights remain in effect for as long as HCP FVE holds at least 35% of the original aggregate principle amount of the Convertible Note or its preferred stock equivalent, as the case may be. Such rights restrict the Company's ability to take certain actions, including, but not limited to: (i) liquidating or dissolving the Company or any subsidiary; (ii) issuing certain securities of the Company senior to those issued to HCP FVE or at a lower price than paid by HCP FVE; (iii) incurring certain indebtedness (including any that is convertible into capital stock of the Company); (iv) paying dividends or other distributions or redeeming any ordinary shares or other equity interests or any securities convertible into our ordinary shares; (v) increasing the number of shares available under our stock option plan, amending such plan, or adopting a new equity incentive plan; (vi) approving any cash incentive or retention plan for its officers and/or directors (unless required to be approved, and actually approved, by the Company's shareholders); (vii) incurring any lien on any of the Company's or any of its subsidiaries' respective properties or assets; or (viii) making any significant change in the nature of the Company's business.

We are required to register with the SEC the resale of the ordinary shares underlying the Convertible Note or preferred stock, as the case may be. Pursuant to the purchase documents, we were required to file such registration statement no later than March 5, 2017 and to obtain its effectiveness no later than June 3, 2017, however the Company and HCP FVE have agreed to postpone the filing of such registration statement.

We are entitled to force the conversion of the Convertible Note or preferred stock, as the case may be, if the ordinary shares trade at 250% of the conversion price for at least 45 consecutive trading days. HCP FVE will have the right to demand that the Convertible Note or the preferred stock, as the case may be, be redeemed after December 5, 2020. The proceeds from the sale will be used by the Company for general working capital purposes, including accelerating the company's ongoing migration of its innovative financial process automation solutions to a cloud-based platform.

The Company has not yet determined if it will draw on the Credit Facility. The issuance of the warrants and the changes to the Convertible Note are conditioned upon the drawing down of the Credit Facility. If the Company elects not to withdraw funds out of the Credit Facility, it will be obligated to pay to Hale Capital Partners, LP a break up fee of equal to three percent (3%) of the Credit Facility.

In December 2017, we secured a \$2.5 million line of credit with a U.S. based bank. The line is secured by the accounts receivables of our U.S. subsidiary and bears interest at 2.5% or 3% (if in stream line mode) per annum and matures in December 2018. We had borrowings outstanding of \$0.8 million against the line of credit at December 31, 2017. Subsequent to December 31, 2017, the borrowings under the line were repaid and the line was cancelled.

Israeli Taxation, Foreign Exchange Regulation and Investment Programs

The following is a summary of the principal Israeli tax laws applicable to us, the Israeli Government programs from which we benefit, and Israeli foreign exchange regulations. This section also contains a discussion of material Israeli tax consequences to our shareholders who are not residents or citizens of Israel. This summary does not discuss all 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. Examples of investors subject to special treatment under Israeli law include residents of Israel, traders in securities, or persons who own, directly or indirectly, 10% or more of our outstanding voting capital, all of whom are subject to special tax regimes not covered in this discussion. Some parts of this discussion are based on new tax legislation that has not been subject to judicial or administrative interpretation. The discussion should not be construed as legal or professional tax advice and does not cover all possible tax consequences.

To the extent that part of the discussion is based on new tax legislation, which has not been subject to judicial or administrative interpretation, we cannot assure you that the tax authorities or the courts will accept the views expressed in this section.

General corporate tax structure in Israel

Israeli companies are subject to corporate tax at the rate of 24% and 25% in 2017 and 2016, respectively. The corporate tax rate decreased from 26.5% in 2015 and 2014. The corporate tax rate in Israel will decrease in 2018 to 23% .

However, as discussed below, the rate is effectively reduced for income derived from our Approved Enterprise and Benefited Enterprise plans.

As of December 31, 2017, we had business loss carry forwards for tax purposes in the amount of \$21.4 . The amount of our carry forward business losses will be offset against relevant taxable future income for an indefinite period.

As of December 31, 2017, the foreign subsidiaries had operating loss carry forwards for tax purposes in the amount of \$28.1. A portion of such losses expires over a period from 2023 through 2037, and some of them can be carried forward indefinitely.

Law for the Encouragement of Capital Investments, 1959

The Law for the Encouragement of Capital Investments, 5719 1959 (the “Investments Law”), provides certain incentives for capital investments in a production facility (or other eligible assets). Generally, an investment program that is implemented in accordance with the provisions of the Investments Law, referred to as an “Approved Enterprise”, is entitled to benefits. These benefits may include cash grants from the Israeli government and tax benefits, based upon, among other things, the location of the facility in which the investment is made or the election of the grantee.

Our facilities in Israel have been granted Approved Enterprise status under the Investments Law. The Investments Law provides that an approved enterprise is eligible for tax benefits on taxable income derived from its approved enterprise programs. The tax benefits under the Investments Law also apply to income generated by a company from the grant of a usage right with respect to know-how developed by the approved enterprise, income generated from royalties, and income derived from a service which is auxiliary to such usage right or royalties, provided that such income is generated within the approved enterprise's ordinary course of business. If a company has more than one approval or only a portion of its capital investments are approved, its effective tax rate is the result of a weighted average of the applicable rates. The tax benefits under the Investments Law are not, generally, available with respect to income derived from products manufactured outside of Israel. In addition, the tax benefits available to an approved enterprise are contingent upon the fulfillment of conditions stipulated in the Investments Law and regulations and the criteria set forth in the specific certificate of approval, as described above. In the event that a company does not meet these conditions, it would be required to refund the amount of tax benefits, plus a consumer price index linkage adjustment and interest.

The Investments Law also provides that an approved enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved enterprise program.

Since we have not yet generated taxable income, the exempt period of benefits to which we are entitled as an Approved Enterprise has not yet begun.

The Investments Law has been amended several times over the last years, with the three most significant changes effective as of April 1, 2005 (the "2005 Amendment"), and as of January 1, 2011 (the "2011 Amendment") and as of effective January 1, 2017 (the "2016 Amendment"). Pursuant to the 2005 Amendment, tax benefits granted in accordance with the provisions of the Investment Law prior to its revision by the 2005 Amendment remain in force but any benefits granted subsequently are subject to the provisions of the amended Investments Law. Similarly, the 2011 Amendment introduced new benefits instead of the benefits granted in accordance with the provisions of the Investments Law prior to the 2011 Amendment, yet companies entitled to benefits under the Investments Law as in effect up to January 1, 2011 may choose to continue to enjoy such benefits, provided that certain conditions are met, or elect instead to forego such benefits and elect the benefits of the 2011 Amendment. The following discussion is a summary of the Investments Law prior to its amendments as well as the relevant changes contained in the subsequent legislation.

Tax benefits for Approved Enterprises approved before April 1, 2005

Under the Investments Law prior to its 2005 amendment, a company that wished to receive benefits had to receive an approval from the Investment Center of the Israeli Ministry of Industry, Trade and Labor, which we refer to as the Investment Center. Each certificate of approval for an Approved Enterprise relates to a specific investment program in the Approved Enterprise, delineated both by the financial scope of the investment and by the physical characteristics of the facility or the asset.

An Approved Enterprise may elect to forego any entitlement to the grants otherwise available under the Investments Law and, instead, participate in an alternative benefits program. Under the alternative benefits track, a company's undistributed income derived from an Approved Enterprise will be exempt from corporate tax for a period of between two and ten years from the first year of taxable income, depending upon the geographic location within Israel of the Approved Enterprise. The benefits commence on the date in which that taxable income is first earned. Upon expiration of the exemption period, the Approved Enterprise is eligible for the reduced tax rates otherwise applicable under the Investment Law for any remainder of the otherwise applicable benefits period. If a company has more than one Approved Enterprise program or if only a portion of its capital investments are approved, its effective tax rate is the result of a weighted combination of the applicable rates. The tax benefits from any certificate of approval relate only to taxable profits attributable to the specific Approved Enterprise. Income derived from activity that is not integral to the activity of the Approved Enterprise will not enjoy tax benefits. Since we have not yet generated taxable

income, the period of benefits to which we are entitled to exempt from corporate tax as an Approved Enterprise has not yet begun.

63

A company that has an Approved Enterprise program is eligible for further tax benefits if it qualifies as a Foreign Investors' Company, or FIC. A FIC eligible for benefits is essentially a company with a level of foreign investment, as defined in the Investments Law, of more than 25%. The level of foreign investment is measured as the percentage of rights in the company (in terms of shares, rights to profits, voting and appointment of directors), and of combined share and loan capital, that are owned, directly or indirectly, by persons who are not residents of Israel. The determination as to whether or not a company qualifies as an FIC is made on an annual basis. A FIC that has an Approved Enterprise program will be eligible for an extension of the period during which it is entitled to tax benefits under its Approved Enterprise status (so that the benefit periods may be up to ten years) and for further tax benefits if the level of foreign investment exceeds 49%. If a company that has an Approved Enterprise program is a wholly owned subsidiary of another company, then the percentage of foreign investment is determined based on the percentage of foreign investment in the parent company.

A company that has elected to participate in the alternative benefits program and that subsequently pays a dividend out of the income derived from the portion of its facilities that have been granted Approved Enterprise status during the tax exemption period will be required to recapture the deferred corporate tax applicable to the amount distributed (grossed up to reflect such tax) at the rate that would have been applicable had such income not been tax-exempted under the alternative route. This rate generally ranges from 10% to 25%, depending on the extent to which non-Israeli shareholders hold such company's shares. Such company may also be required to record a deferred tax liability with respect to such tax-exempt income prior to its distribution.

In addition, dividends paid out of income generated by an Approved Enterprise (or out of dividends received from a company whose income is generated by an Approved Enterprise) are generally subject to withholding tax at the rate of 15%, or at the lower rate provided under an applicable tax treaty. The 15% tax rate is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years thereafter. After this period, the withholding tax is applied at a rate of up to 30%, or at the lower rate under an applicable tax treaty. In the case of a FIC, the 12-year limitation on reduced withholding tax on dividends does not apply.

The Investments Law also provides that an Approved Enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved investment program. This benefit is an incentive granted by the Israeli government regardless of whether the alternative benefits program is elected.

The benefits available to an Approved Enterprise are subject to the fulfillment of conditions stipulated in the Investments Law and its regulations and the criteria in the specific certificate of approval with respect thereto, as described above. If a company does not meet these conditions, it may be required to refund the amount of tax benefits, together with consumer price index linkage adjustment and interest.

The 2005 Amendment

On April 1, 2005, an amendment to the Investments Law came into effect. The 2005 amendment revised the criteria for investments qualified to receive tax benefits. An eligible investment program under the amendment will qualify for benefits as a Benefited Enterprise (rather than the previous terminology of Approved Enterprise). Among other things, the amendment provides tax benefits to both local and foreign investors and simplifies the approval process. The period of tax benefits for a new Benefited Enterprise commences in the "Year of Commencement." This year is the later of (1) the year in which taxable income is first generated by a company, or (2) a year selected by the company for commencement, on the condition that the company meets certain provisions provided by the Investments Law (Year of Election). The amendment does not apply to investment programs approved prior to December 31, 2004. The new tax regime applies to new investment programs only. Pursuant to the 2005 Amendment, the Investment Center will continue to grant Approved Enterprise status to qualifying investments. However, the 2005 Amendment limits the scope of enterprises that may be approved by the Investment Center by setting criteria for the approval of a facility as an Approved Enterprise, such as provisions generally requiring that at least 25% of the Approved Enterprise's income be derived from export to specific markets with a population of at least 12 million.

The 2005 Amendment provides that the approval of the Investment Center is required only for Approved Enterprises that receive cash grants. As a result, a company is no longer required to obtain the advance approval of the Investment Center in order to receive tax benefits. Rather, a company may claim the tax benefits offered by the Investments Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set forth in the 2005 Amendment. A company that has a Benefited Enterprise may, at its discretion, approach the Israeli Tax Authority for a pre-ruling confirming that it is in compliance with the provisions of the Investments Law. Tax benefits are available under the 2005 Amendment to production facilities (or other eligible facilities) that derive more than 25% of their business income from export to specific markets with a population of at least 12 million. In order to receive the tax benefits, the 2005 Amendment states that a company must make an investment which meets all the conditions that are set out in the amendment for tax benefits and which exceeds a minimum amount specified in the Investments Law. Such investment entitles a company to a Benefited Enterprise status with respect to the investment, and may be made over a period of no more than three years ending at the end of the year in which the company requested to have the tax benefits apply to the Benefited Enterprise. Where a company requests to have the tax benefits apply to an expansion of existing facilities, only the expansion will be considered to be a Benefited Enterprise, and the company's effective tax rate will be the weighted average of the applicable rates. In such case, the minimum investment required in order to qualify as a Benefited Enterprise must exceed a certain percentage of the value of the company's production assets before the expansion.

The extent of the tax benefits available under the 2005 Amendment to qualifying income of a Benefited Enterprise are determined, among other things, by the geographic location of the Benefited Enterprise. Such tax benefits include an exemption from corporate tax on undistributed income for a period of between two to ten years, depending on the geographic location of the Benefited Enterprise within Israel, and a reduced corporate tax rate of between 10% to 25% for the remainder of the benefit period, depending on the balance of the Limitation period (described below) and the-level of foreign investment in the company in each year, as explained above.

The duration of tax benefits is subject to a limitation of the earlier of 7 to 10 years from the year of commencement, or 12 years from the first day of the Year of Election ("Limitation period").

If a company distributes dividends from tax-exempt income, the company will be taxed on the otherwise exempt income at the same reduced corporate tax rate that would have applied to that income. Distribution of dividends derived from income that was taxed at reduced rates, but not tax-exempt, does not result in additional tax consequences to the company. Shareholders who receive dividends derived from Approved Enterprise or Benefited Enterprise income are generally taxed at a rate of 15%, which is withheld and paid by the company paying the dividend, if the dividend is distributed during the benefits period or within the following 12 years (the limitation does not apply to a Foreign Investors Company, which is a company in which more than 25% of its shares are owned by non-Israeli residents).

The tax benefits available under Approved Enterprise or Benefited Enterprise relate only to taxable income attributable to the specific Approved Enterprise or Benefited Enterprise, and our effective tax rate will be the result of a weighted combination of the applicable rates.

Percent of Foreign Ownership	Rate of Reduced Tax	Reduced Tax Period	Tax Exemption Period
0-25%	25%	5 years	2 years
25-49%	25%	8 years	2 years
49-74%	20%	8 years	2 years
74-90%	15%	8 years	2 years
90-100%	10%	8 years	2 years

The Company received approvals for an establishment program and three expansions during the years 1990, 1991, 1999 and 2000.

We believe that our Approved Enterprise and Benefited Enterprise programs currently operate in compliance with all applicable conditions and criteria, but we cannot assure you that they will continue to do so. If we do not fulfill these conditions, in whole or in part, the benefits can be cancelled and we may be required to refund the amount of the benefits, linked to the Israeli consumer price index plus interest.

The Company elected 2009 as a year of election under the Amendment.

To date, the Company has not utilized the benefits of the Investments Law, as amended subsequent to April 1, 2005, because of utilizing carry forward losses from previous years for tax purposes.

The 2005 amendment to the Investments Law treats the repurchase of shares out of Benefited Enterprise tax exempt income as deemed dividend.

As a result of the 2005 amendment, tax-exempt income attributed to Benefited Enterprise will subject us to taxes also upon complete liquidation.

Reform of the Investments Law – “2011 Amendment”

The 2011 Amendment canceled the availability of the benefits granted in accordance with the provisions of the Investment Law prior to 2011 and, instead, introduced new benefits for income generated by a “Preferred Company” through its Preferred Enterprise (as such term is defined in the Investments Law) effective as of January 1, 2011 and onward. A Preferred Company is defined as either (i) a company incorporated in Israel and not fully owned by a governmental entity or (ii) a limited partnership (a) that was registered under the Israeli Partnerships Ordinance and (b) all limited partners of which are companies incorporated in Israel, but not all of them are governmental entities, which, in the case of the company and companies referenced in clauses (i) and (ii)(b), have, among other things, Preferred Enterprise status and are controlled and managed from Israel. According to the 2011 amendment, the benefit tracks in the Investment Law were modified and a flat tax rate would apply to the Company’s entire preferred income. We will be able to choose to apply the amendment (the waiver is non-recourse) and from then the uniform corporate tax rate will be 9% in development Zone A and 16% elsewhere in Israel.

A dividend distributed from income which is attributed to a Preferred Enterprise/Special Preferred Enterprise will be subject to withholding tax at source at the following rates: (i) Israeli resident corporation – 0%, (ii) Israeli resident individual –20% (iii) non-Israeli resident - 20% subject to a reduced tax rate under the provisions of an applicable double tax treaty.

We may choose not to apply the 2011 amendment, in which case the Company will remain subject to the Investments Law as in effect prior to the 2011 amendment until the expiration of the Company’s current investment programs. We are examining the possible effect of the amendment on the financial statements, if at all.

Tax Benefits under the 2016 Amendment

In December 2016, an additional amendment to the Law was passed (the “2016 Amendment”), which provides for:

- (1) A reduction in the tax rate for Preferred Enterprises in Development Zone A from 9% to 7.5%; and
- (2) Additional benefits to Preferred Technological Enterprises by reducing the tax rate on preferred Technological Enterprise income (as such is defined in the 2016 Amendment) to 12%.

The 2016 Amendment came into effect in January 2017 as regulations for its implementation were promulgated by the Minister of Finance. The Company examined the possible effect of the 2016 amendment and at this time does not believe it will elect to apply the 2016 amendment.

Law for the Encouragement of Industry (Taxes), 1969

We believe that we currently qualify as an Industrial Company within the meaning of the Law for the Encouragement of Industry (Taxes), 1969 (the “Industrial Encouragement Law”). The Industrial Encouragement Law defines an “Industrial Company” as a company that is resident in Israel and that derives at least 90% of its income in any tax year, other than income from defense loans, capital gains, interest and dividends, from an enterprise whose major activity in a given tax year is industrial production.

The following are the principal corporate tax benefits that are available to an Industrial Company:

§ Amortization of the cost of purchased know-how patents used for the development or promotion of the Industrial Enterprise over an eight-year period commencing on the year in which such rights were first exercised for tax purposes.

§ Accelerated depreciation rates on equipment and buildings.

§ Under specified conditions, an election to file consolidated tax returns with related Israeli Industrial Companies.

§ Expenses related to a public offering are deductible in equal amounts over three years commencing on the year of offering.

Eligibility for the benefits under the Industrial Encouragement Law is not subject to receipt of prior approval from any governmental authority. We cannot assure you that we will continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

Tax Benefits for Research and Development

Israeli tax law allows, under specified conditions, a tax deduction for research and development expenditures, including capital expenditures, for the year in which they are incurred. Such expenditures must relate to scientific research and development projects, and must be approved by the relevant Israeli government ministry, determined by the field of research. Furthermore, the research and development must be for the promotion of the company’s business and carried out by or on behalf of the company seeking such tax deduction. However, the amount of such deductible expenses is reduced by the sum of any funds received through government grants for the finance of such scientific research and development projects. Expenditures not so approved by the relevant Israeli government ministry, but otherwise qualifying for deduction, are deductible over a three-year period.

Taxation of our Shareholders

The following is a short summary of the material provisions of the tax environment to which shareholders may be subject. This summary is based on the current provisions of tax law. To the extent that the discussion is based on new tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the views expressed in the discussion will be accepted by the appropriate tax authorities or the courts.

The summary does not address all of the tax consequences that may be relevant to all purchasers of our common shares in light of each purchaser’s particular circumstances and specific tax treatment. For example, the summary below does not address the tax treatment of residents of Israel and traders in securities who are subject to specific tax regimes. As individual circumstances may differ, holders of our common shares should consult their own tax adviser as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of common shares. The following is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations. Each individual should consult his or her own tax or legal adviser.

Taxation of Israeli Shareholders on Capital Gains from Sale of Shares

Israeli law generally imposes a capital gains tax on the sale of capital assets located in Israel, including shares in Israeli resident companies, unless a specific exemption is available or unless a treaty between Israel and the country of the non-resident provides otherwise. The Ordinance distinguishes between the “Real Capital Gain” and the “Inflationary Surplus”. The Inflationary Surplus is a portion of the total capital gain which is equivalent to the increase of the relevant asset’s purchase price which is attributable to the increase in the Israeli consumer price index (CPI) or, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The Real Capital Gain is the excess of the total capital gain over the Inflationary Surplus.

An individual is subject to a 25% tax rate on real capital gains derived from the sale of shares. Additionally, if such shareholder is considered a “substantial shareholder” (generally a shareholder who holds directly or indirectly 10% or more of the right to profits, right to nominate a director or voting rights) of the company issuing the shares, the tax rate is 30%. Individual shareholders dealing with securities in Israel are taxed at their marginal tax rates applicable to business income.

Prior to January 1, 2012, the capital gain tax rate applicable to individuals was 20% (or 25% if the selling individual shareholder was a Substantial Shareholder at any time during the 12-month period preceding the sale). With respect to assets (not shares that are listed on a stock exchange) purchased on or after January 1, 2003, the portion of the gain generated from the date of acquisition until December 31, 2011 will be subject to the previous capital gains tax rates (20% or 25%) and the portion of the gain generated from January 1, 2012 until the date of sale will be subject to the new tax rates (25% or 30%).

The determination of whether the individual is a substantial shareholder will be made on the date that the securities are sold. In addition, the individual will be deemed to be a substantial shareholder if at any time during the 12 months preceding this date he had been a substantial shareholder.

Israeli Resident Corporations. Under present Israeli tax legislation, the tax rate applicable to Real Capital Gain derived by Israeli resident corporations from the sale of shares of an Israeli company is the general corporate tax rate. As described above, the corporate tax rate in 2016 was 25% , and is planned to decrease to 24% and 23% in 2017 and 2018 respectively.

Taxation of Israeli Shareholders on Receipt of Dividends

Israeli Resident Individuals. Israeli residents who are individuals are generally subject to Israeli income tax for dividends paid on our common shares (other than bonus shares or share dividends) at 25%, or 30% if the recipient of such dividend is a Substantial Shareholder at the time of distribution or at any time during the preceding 12-month period. However, dividends distributed from taxable income accrued during the period of benefit of an Approved Enterprise, Benefited Enterprise or Preferred Enterprise are subject to withholding tax at the rate of 15%, if the dividend is distributed during the tax benefit period under the Investments Law or within 12 years after that period.

Israeli Resident Corporations. Israeli resident corporations are generally exempt from Israeli corporate tax for dividends paid on our common shares.

Taxation of Non-Israeli Shareholders on Capital Gain from Sale of shares

Non-Residents of Israel. Israeli capital gain tax is imposed on the disposal of capital assets by a non-Israeli resident if such assets are either (i) located in Israel; (ii) shares or rights to shares in an Israeli resident company; or (iii) represent, directly or indirectly, rights to assets located in Israel, unless a tax treaty between Israel and the seller’s country of residence provides otherwise. As mentioned above, Real Capital Gain derived by a company is generally subject to tax at the corporate tax rate of 25% or, if derived by an individual, at the rate of 25% or 30%, if generated from an asset purchased on or after January 1, 2003. Individual and corporate shareholders dealing in securities in Israel are taxed at the tax rates applicable to business income.

Non-residents of Israel, including corporations, will generally be exempt from any capital gains tax from the sale of shares traded on a recognized stock exchange outside of Israel (including NASDAQ), provided that such shareholders did not acquire their shares prior to an initial public offering and that the gains are not derived through a permanent establishment that the non-resident maintains in Israel. However, non-Israeli corporations will not be entitled to such exemption if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli corporation, or (ii) is the beneficiary or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly. In any case, these tax rates are subject to the provisions of any applicable tax treaty. On January

2009, an amendment to the Israeli tax regime became effective all the non-residents of Israel will generally be exempt from any capital gains tax from the sales of shares traded on a recognized stock exchange outside of Israel.

68

In addition, pursuant to the Convention Between the U.S. Government and the Government of Israel with Respect to Taxes on Income, as amended (the “United States-Israel Tax 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 United States-Israel Tax Treaty and who is entitled to claim the benefits afforded to such person by the United States-Israel Tax Treaty (a “United States Treaty Resident”) generally will not be subject to the Israeli capital gains tax unless such United States Treaty 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 certain conditions. However, under the United States-Israel Tax Treaty, such United States Treaty 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 in U.S. laws applicable to foreign tax credits. The United States-Israel Tax Treaty does not relate to U.S. state or local taxes.

Taxation of Non-Israeli Shareholders on Receipt of Dividends

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. These sources of income include passive income, including dividends, royalties and interest. On the distribution of dividends by a publicly traded company, income tax is withheld at source, at the rate of 25% for dividends paid to an individual or foreign corporation, and 15% for dividends generated by an Approved Enterprise, unless in each case a different rate is provided in a treaty between Israel and shareholder’s country of residence. Under the U.S.-Israel tax treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a U.S. resident will be 25%. However, the maximum tax rate on dividends not generated by an Approved Enterprise paid to a U.S. corporation holding at least 10% of our voting power is 12.5%.

In some instances where our shareholders may be liable to Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source.

A non-resident of Israel who receives dividends from which tax was withheld is generally exempt from the duty to file returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer, and the taxpayer has no other taxable sources of income in Israel.

Foreign Exchange Regulations

An Israeli company calculates its tax liability in US dollars according to certain orders. The tax liability, as calculated in US dollars is translated into NIS according to the exchange rate as of December 31st of each year.

Dividends, if any, paid to the holders of our ordinary shares, 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, may be paid in non-Israeli currency. If these amounts are paid in Israeli currency, they may be converted into freely repatriable U.S. dollars at the rate of exchange prevailing at the time of conversion. In addition, the statutory framework for the potential imposition of exchange controls has not been eliminated, and may be restored at any time by administrative action.

U.S. FEDERAL INCOME TAX CONSIDERATIONS

THE DISCUSSION BELOW IS BASED UPON THE SECTIONS OF THE INTERNAL REVENUE CODE, TREASURY REGULATIONS, PUBLISHED INTERNAL REVENUE SERVICE RULINGS, PUBLISHED ADMINISTRATIVE POSITIONS OF THE INTERNAL REVENUE SERVICE AND COURT DECISIONS THAT ARE CURRENTLY APPLICABLE, ANY OR ALL OF WHICH COULD BE MATERIALLY AND ADVERSELY CHANGED AT ANY TIME, POSSIBLY ON A RETROACTIVE BASIS. THE FOLLOWING DISCUSSION IS FOR GENERAL INFORMATION ONLY AND IS NOT INTENDED TO BE, NOR SHOULD IT BE CONSTRUED TO BE, LEGAL OR TAX ADVICE TO ANY HOLDER OR PROSPECTIVE HOLDER OF ORDINARY SHARES

AND NO OPINION OR REPRESENTATION WITH RESPECT TO THE UNITED STATES FEDERAL INCOME TAX CONSEQUENCES TO ANY SUCH HOLDER OR PROSPECTIVE HOLDER IS MADE. ACCORDINGLY, HOLDERS AND PROSPECTIVE HOLDERS OF ORDINARY SHARES SHOULD CONSULT THEIR OWN TAX ADVISORS ABOUT THE FEDERAL, STATE, LOCAL, AND FOREIGN TAX CONSEQUENCES OF PURCHASING, OWNING AND DISPOSING OF ORDINARY SHARES.

The following is a discussion of material United States Federal income tax consequences generally applicable to U.S. Holders (as defined below) who acquire our ordinary shares and hold them as capital assets. This discussion does not address all potentially relevant United States Federal income tax matters, and it does not address consequences peculiar to persons subject to special provisions of United States Federal income tax law, such as, for example, tax-exempt organizations, qualified retirement plans, persons subject to alternative minimum tax, financial institutions, insurance companies, real estate investment trusts, regulated investment companies, broker-dealers and shareholders who acquired their shares through the exercise of employee share options or otherwise as compensation. In addition, this discussion only applies to common shares held by U.S. Holders as capital assets within the meaning of Section 1221 of the Internal Revenue Code, and does not cover any state, local or foreign tax consequences.

As used herein, the term “U.S. Holder” means a person, with the exception of those subject to special provisions of Federal income tax law, that holds our common shares that is (i) an individual who is a citizen or resident of the United States, (ii) a corporation organized under the laws of the United States, (iii) an estate, the income of which is subject to United States Federal income tax without regard to its source and (iv) a trust if (A) a United States court is able to exercise primary supervision over administration of the trust and one or more United States persons have authority to control all substantial decisions of the trust or (B) the trust has in effect a valid election under applicable United States Treasury Regulations to be treated as a U.S. person.

If a partnership or an entity treated as a partnership for United States Federal income tax purposes holds common shares, the United States Federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. Partnerships or a partner in a partnership holding common shares should consult their own tax advisor regarding the consequences of the ownership and disposition of common shares by the partnership.

The term "Non-U.S. Holder" means a beneficial owner of an ordinary share who is not a U.S. Holder. The tax consequences to a Non-U.S. Holder may differ substantially from the tax consequences to a U.S. Holder. Certain aspects of U.S. federal income tax relevant to a Non-U.S. Holder also are discussed below.

Taxation of ordinary shares

Taxation of Dividends Paid On Ordinary Shares

Subject to the discussion under “Tax Consequences if the Company is a Passive Foreign Investment Company” below, a U.S. Holder generally will be required to include in gross income as ordinary income the amount of any distribution paid on ordinary shares, including any Israeli taxes withheld from the amount paid, to the extent the distribution is paid out of our current or accumulated earnings and profits as determined for U.S. federal income tax purposes. In general, distributions in excess of such earnings and profits will be applied against and will reduce (but not below zero) the U.S. Holder’s tax basis in the ordinary shares and, to the extent in excess of such basis, will be treated as gain from the sale or exchange of ordinary shares.

A non-corporate U.S. Holder that meets certain eligibility requirements may qualify for a 20% or lower rate of U.S. federal income taxation on dividends paid if the Company is a “qualified foreign corporation” for U.S. federal income tax purposes, although the actual rates may be higher due to the phase out of certain tax deductions, exemptions and credits.

The Company generally will be treated as a “qualified foreign corporation” if (i) the Company is eligible for benefits under the income tax treaty between the United States and Israel (the “Treaty”) which contains an exchange of information program, or (ii) the ordinary shares are readily tradable on an established securities market in the United States. Because the Treaty has been identified by the U.S. Treasury as a qualifying treaty and the Company should be eligible for benefits under the Treaty, the Company should currently be treated as a qualified foreign corporation. However, no assurance can be given that a change in circumstances will not affect the Company’s treatment as a qualified foreign corporation for U.S. federal income tax purposes in any taxable year. In addition, a non-corporate U.S. Holder will generally not be eligible for the reduced rate (a) if such U.S. Holder has not held the ordinary shares for at least 61 days of the 121-day period beginning on the date which is 60 days before the ex-dividend date, (b) to the extent the U.S. Holder is under an obligation to make related payments on substantially similar or related property, or (c) with respect to any portion of a dividend that the U.S. Holder elects to treat as investment income under Section 163(d)(4)(B) of the Code. Any days during which the U.S. Holder has diminished its risk of loss with respect to the ordinary shares (for example, by holding an option to sell the ordinary shares), are not counted towards meeting the 61-day holding period. Non-corporate U.S. Holders should consult their own tax advisors concerning whether dividends received by them qualify for the reduced rate of tax.

U.S. Holders will generally include in their gross income any dividend paid in NIS, including the amount of any Israeli taxes withheld, in an amount equal to the U.S. dollar value of the NIS received, calculated by reference to the exchange rate in effect on the date the dividends are received, regardless of whether the dividend payments are actually converted into U.S. dollars. U.S. Holders will have a tax basis in any NIS distributed by the Company equal to the U.S. dollar value of the NIS on the date of receipt. Generally, any gain or loss resulting from exchange rate fluctuations during the period from the date the U.S. Holder includes the dividend payment in income to the date the payment is converted into U.S. dollars will be treated as ordinary income or loss and will be U.S. source income or loss for U.S. foreign tax credit purposes.

U.S. Holders may have the option of claiming the amount of any Israeli income taxes withheld at source either (1) as a deduction from gross income but only for a year in which the U.S. Holder elects to do so with respect to all foreign income taxes, or (2) subject to the foreign tax credit limitation, as a dollar-for-dollar credit against the U.S. Holder’s U.S. federal income tax liability. Individuals who do not claim itemized deductions, but instead utilize the standard deduction, may not claim a deduction for the amount of the Israeli income taxes withheld, but such amount may be claimed as a credit against the individual’s U.S. federal income tax liability. The amount of foreign income taxes which may be claimed as a credit in any year is subject to complex limitations and restrictions, which must be determined on an individual basis by each U.S. Holder, and may further be impacted by the provisions of the Treaty. The total amount of allowable foreign tax credits in any year cannot exceed regular U.S. tax liability for the year attributable to foreign source taxable income. 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. In addition, distributions of current or accumulated earnings and profits will be foreign source passive income for U.S. foreign tax credit purposes and will not qualify for the dividends received deduction available to certain corporations.

Taxation of the Disposition of Ordinary Shares

Upon the sale, exchange or other disposition of ordinary shares, subject to the discussion under “Tax Consequences if the Company is a Passive Foreign Investment Company” below a U.S. Holder generally will recognize capital gain or loss in an amount equal to the difference between such U.S. Holder’s adjusted basis in the ordinary shares, which is usually the cost of such shares, and the amount realized on the disposition. Capital gain from the sale, exchange or other disposition of ordinary shares held for more than one year is long-term capital gain. Long-term capital gain of a

non-corporate U.S. Holder is eligible to be taxed at reduced rates. However, tax rates are subject to change and U.S. Holders should consult their tax advisors. Gains and losses recognized by a U.S. Holder on a sale, exchange or other disposition of ordinary shares will be treated as U.S source income or loss for U.S foreign tax credit purposes. The deductibility of capital losses is subject to limitations.

Tax Consequences if the Company is a Passive Foreign Investment Company

The Company will be a passive foreign investment company, or PFIC, if 75% or more of its gross income in a taxable year, including the pro rata share of the gross income of any company, U.S. or foreign, in which it is considered to own 25% or more of the shares by value, is passive income. Alternatively, the Company will be considered to be a PFIC if at least 50% of its assets in a taxable year, determined quarterly and averaged over the year including the pro rata share of the assets of any company in which it is considered to own 25% or more of the shares by value, are held for the production of, or produce, passive income. Passive income includes amounts derived by reason of the temporary investment of funds raised in the Company's public offerings.

If the Company is a PFIC, and a U.S. Holder does not make one of the elections described below with respect to such shares, the U.S. Holder would be subject to special rules with respect to (1) any excess distribution (i.e., the portion of any distributions received by the U.S. Holder on the ordinary shares in a taxable year in excess of 125% of the average annual distributions received by the U.S. Holder in the three preceding taxable years, or, if shorter, the U.S. Holder's holding period for the ordinary shares), and (2) any gain realized on the sale, exchange or other disposition of the ordinary shares. Under these special rules:

- the excess distribution or gain would be allocated ratably to each day over the U.S. Holders' aggregate holding period for the ordinary shares

- the amount allocated to the current taxable year and any taxable year before the Company became a PFIC would be taxed as ordinary income; and

- the amount allocated to each of the other taxable years would be subject to tax at the highest rate of tax in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed with respect to the resulting tax attributable to each such other taxable year.

In addition, if a U.S. Holder who is an individual dies while owning ordinary shares, such holder's successor generally would not receive a step-up in tax basis with respect to such ordinary shares.

The special PFIC rules described above will not apply to a U.S. Holder if the U.S. Holder makes a timely and effective election to treat the Company as a "qualified electing fund" ("QEF"), which election generally must be made in the first year of the U.S. Holder's holding period for the ordinary shares in which the Company was a PFIC, and if the Company complies with certain reporting requirements. Instead, a U.S. Holder that makes a QEF election is required for each taxable year to include in its income a pro rata share of (1) the "ordinary earnings" of the Company, which will be taxed as ordinary income and (2) the "net capital gain" of the Company, which will be taxed as long-term capital gain to such U.S. Holder. A U.S. Holder that makes a QEF election will be subject to U.S. federal income tax on such amounts for each taxable year in which the Company is a PFIC, regardless of whether such amounts are actually distributed to such U.S. Holder by the Company. However, a U.S. Holder that makes a QEF election may, subject to certain limitations, elect to defer payment of current U.S. federal income tax on such amounts, subject to an interest charge.

A U.S. Holder that makes a QEF election with respect to the Company generally (1) may receive a tax-free distribution from the Company to the extent that such distribution represents "earnings and profits" of the Company that were previously included in income by the U.S. Holder because of such QEF election and (2) will adjust such U.S. Holder's tax basis in its ordinary shares to reflect the amount included in income (resulting in an increase in basis) or allowed as a tax-free distribution (resulting in a decrease in basis) because of the QEF election. In addition, a U.S. Holder that makes a QEF election generally will recognize capital gain or loss on the sale or other taxable disposition of Company ordinary shares.

The Company has agreed to supply U.S. Holders with the information needed to report income and gain pursuant to a QEF election in the event that the Company is classified as a PFIC. The QEF election is made on a U.S. Holder-by-U.S. Holder basis and can be revoked only with the consent of the IRS. A U.S. Holder generally makes a QEF election by attaching a completed IRS Form 8621, including the PFIC annual information statement, to a timely filed United States federal income tax return. Even if a QEF election is not made, a U.S. Holder in a PFIC generally must file a completed IRS Form 8621 every year. The QEF election must be made on or before the U.S. holder's tax return due date, as extended, for the first taxable year to which the election will apply.

As an alternative to making a QEF election, a U.S. Holder of PFIC stock which is publicly traded may, in certain circumstances, elect to mark the stock to market annually (a “mark-to-market election”), recognizing as ordinary income or loss each year an amount equal to the difference as of the close of the taxable year between the U.S. holder’s fair market value of the PFIC stock and its adjusted basis in the PFIC stock. Losses would be allowed only to the extent of net mark-to-market gain previously included by the U.S. Holder under the election for prior taxable years. This election is available provided that the Company ordinary shares constitute “marketable stock,” which includes stock of a PFIC that is “regularly traded” on a “qualified exchange or other market,” as specifically defined in the Code. If a U.S. Holder makes a mark-to-market election with respect to ordinary shares for the first taxable year of the U.S. Holder in which the U.S. Holder holds (or is deemed to hold) the ordinary shares and for which the Company is determined to be a PFIC, such U.S. Holder generally will not be subject to the PFIC rules described above with respect to its ordinary shares. A mark-to-market election applies to the tax year for which the election is made and to each subsequent year, unless the ordinary shares cease to be marketable, or the IRS consents to revocation of the election.

The Company believes that it was not a PFIC in 2016. However, the tests for determining PFIC status are applied annually, and it is difficult to make accurate predictions of future income and assets which are relevant to this determination. Accordingly, we cannot be certain whether we will be treated as a PFIC for any taxable year. Absent one of the elections described above, U.S. Holders who hold ordinary shares during a period when the Company is a PFIC will be subject to the foregoing rules, regardless of whether the Company ceases to be a PFIC in one or more subsequent years. U.S. Holders are urged to consult their tax advisors about the PFIC rules, including the consequences to them of making a mark-to-market or QEF election with respect to the Company’s ordinary shares, in the event that the Company qualifies as a PFIC.

Legislation regarding Medicare Tax

For taxable years beginning after December 31, 2012, a U.S. Holder that is an individual or estate, or a trust that does not fall into a special class of trusts that is exempt from such tax, will be subject to a 3.8% tax on the lesser of (1) the U.S. Holder’s “net investment income” for the relevant taxable year and (2) the excess of the U.S. Holder’s modified adjusted gross income for the taxable year over a certain threshold (which, in the case of individuals, will be between \$125,000 and \$250,000 depending on the individual’s circumstances). A U.S. Holder’s “net investment income” will generally include its dividend income and its net gains from the disposition of shares, unless such dividends or net gains are derived in the ordinary course of the conduct of a trade or business (other than a trade or business that consists of certain passive or trading activities). If you are a U.S. Holder that is an individual, estate or trust, you are urged to consult your tax advisors regarding the applicability of the Medicare tax to your income and gains in respect of your investment in the shares.

Tax Consequences for Non-U.S. Holders of Ordinary Shares

Except as described in the section entitled “Information Reporting and Back-up Withholding”, a Non-U.S. Holder of ordinary shares generally will not be subject to U.S. federal income or withholding tax on the payment of dividends on, and the proceeds from the disposition of, ordinary shares, unless:

- such item is effectively connected with the conduct by the Non-U.S. Holder of a trade or business in the United States and, generally in the case of a resident of a country which has an income tax treaty with the United States, such item is attributable to a permanent establishment or, in the case of an individual, a fixed place of business, in the United States;

- the Non-U.S. Holder is an individual who holds the ordinary shares as a capital asset and is present in the United States for 183 days or more in the taxable year of the disposition and certain other conditions are met; or

- the Non-U.S. Holder is subject to tax pursuant to the provisions of U.S. tax law applicable to U.S. expatriates.

Information Reporting and Back-up Withholding

In general, U.S. Holders may be subject to certain information reporting requirements under the Code relating to their purchase and/or ownership of stock of a foreign corporation such as the Company. Failure to comply with these information reporting requirements may result in substantial penalties.

For example certain individuals who are U.S. Holders are required to file Form 8938 to report the ownership of specified foreign financial assets for tax years beginning after March 18, 2010 if the total value of those assets exceeds an applicable threshold amount (subject to certain exceptions). For these purposes, a specified foreign financial asset includes not only a financial account (as defined by the Code and applicable Treasury Regulations) maintained by a foreign financial institution, but also any stock or security issued by a non-U.S. person, any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. person and any interest in a foreign entity, provided that the asset is not held in an account maintained by a U.S. financial institution. The minimum applicable threshold amount is generally \$50,000 in the aggregate, but this threshold amount varies depending on whether the individual lives in the U.S., is married, files a joint income tax return with his or her spouse, etc. Certain domestic entities that are U.S. Holders may also be required to file Form 8938 in the near future. U.S. Holders are urged to consult with their tax advisors regarding their reporting obligations, including the requirement to file IRS Form 8938.

Information reporting requirements will generally apply to payments with respect to ordinary shares paid to a U.S. Holder other than certain exempt recipients (such as corporations). Backup withholding will apply to such payments if such U.S. Holder fails to provide a taxpayer identification number or certification of other exempt status or fails to comply with the applicable requirements of the backup withholding rules. Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against such U.S. Holder's United States Federal income tax liability provided the required information is furnished by such U.S. Holder to the Internal Revenue Service. A U.S. Holder who does not provide a correct taxpayer identification number may be subject to penalties imposed by the Internal Revenue Service.

Unless otherwise provided by the IRS, if the Company is a PFIC, a U.S. Holder is generally required to file an informational return annually to report its ownership interest in the PFIC.

Non-U.S. Holders generally are not subject to information reporting or back-up withholding with respect to dividends paid on, or upon the disposition of, ordinary shares, provided that such non-US Holder certifies to its foreign status, or otherwise establishes an exemption. A non-U.S. holder will be required to provide a certificate of non-U.S. status on an appropriate IRS Form W-8.

Available Information

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended, applicable to foreign private issuers and fulfill the obligations with respect to such requirements by filing reports with the SEC. You may read and copy any document we file with the SEC without charge at the SEC's public reference room at 100 F Street, N.E., Washington, D.C. 20549. Certain of our SEC filings are also available to the public at the SEC's website at <http://www.sec.gov>. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. In addition, all corporate documents filed with the SEC must be available to the public by law and are available for review at our headquarters, 2 Ben Gurion St, Ramat Gan, 5257334, Israel.

As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and "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 with the SEC as frequently or as promptly as United States companies whose securities are registered under the Exchange Act. However, we generally publicly

announce our quarterly and year-end results periodically, and furnish certain periodic information with the SEC under cover of Form 6-K.

74

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of changes in the value of our financial instruments caused by fluctuations in interest rates, foreign exchange rates and equity prices. We do not engage in trading market-risk instruments or purchase hedging or “other than trading” instruments that are likely to expose us to market risk, whether interest rate, commodity price or equity price risk. We have not purchased options or entered into swaps or forward or futures contracts and do not use derivative financial instruments for speculative trading purposes.

We maintain operations and generate revenues in a number of countries. The results of operations and the financial position of our local operations are generally reported in the relevant local currencies and then translated into U.S. dollars at the applicable exchange rates for inclusion in our consolidated financial statements, exposing us to currency translation risk.

In addition, we are exposed to currency transaction risk because some of our expenses are incurred in a different currency from the currency in which our revenues are received and from which our revenues and expenses are reported. Our most significant currency exposures are to the Euro, New Israeli Shekel, British Pound, Singapore dollar, Australian dollar, Japanese Yen and Brazilian Real. In periods when the U.S. dollar strengthens against these currencies our revenue may be adversely impacted. In periods when the U.S. dollar weakens against these currencies, our expenses may be adversely affected.

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

(a) Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of December 31, 2017. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures as of such date were effective to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Report of Management on Internal Control Over Financial Reporting.

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Management assessed the effectiveness of internal control over financial reporting as of December 31, 2017 based on the criteria in “Internal Control- Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on that assessment, management has concluded that our internal control over financial reporting was effective as of December 31, 2017 under those criteria.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements, and can only provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

(c) Not applicable

(d) There has been no change in our internal control over financial reporting that occurred during the fiscal year ended December 31, 2017, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

The Board of Directors has determined that Osnat Segev-Harel, a member of our audit committee, is an audit committee financial expert and is independent pursuant to the rules of the NASDAQ Stock Market. Osnat Segev-Harel is an independent director as defined by the NASDAQ listing standards.

ITEM 16B. CODE OF ETHICS

We have in place a Code of Business Conduct and Ethics that applies to all directors, officers and employees. This code, as applied to our principal financial officers (i.e. our principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions), is our “code of ethics” within the meaning of Section 406 of the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder. This code is also our “code of conduct” within the meaning of NASDAQ Rule 5610. The full text of the Code of Business Conduct and Ethics is available at our Internet website at <http://www.topimagesystems.com>.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Audit Fees

In 2017 and 2016, we engaged the services of Kost Forer Gabbay and Kasierer, an independent registered accounting firm (a member of Ernst & Young Global) (“EY”), to audit our financial statements. The aggregate fees billed by EY for professional services rendered for the audit of our annual financial statements included in this Annual Report and other services in connection with statutory and regulatory filings or engagements for the fiscal year ended December 31, 2017 and 2016 were \$328,000 and \$246,000, respectively.

Tax Fees

For the fiscal years ended December 31, 2017 and 2016 the aggregate fees billed for tax compliance, tax advice and tax planning by EY were \$12,

Other services

For the fiscal year ended December 31, 2017 the aggregate fees billed EY for non-audit services were \$7,655. For the fiscal year ended December 31, 2016 the aggregate fees billed EY for non-audit services were \$21,742.

Before EY is engaged by our subsidiaries or us to render any auditing or permitted non-audit related service, the engagement must be:

· approved by our audit committee; or

· entered into pursuant to pre-approval policies and procedures established by the audit committee, provided the policies and procedures are detailed as to the particular service, the audit committee is informed of each service, and such policies and procedures do not include delegation of the audit committee’s responsibilities to management.

The audit committee has considered the nature and amount of the fees billed by EY, and believes that the provision of the services for activities unrelated to the audit is compatible with maintaining Ernst & Young’s independence.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS OF AUDIT COMMITTEES

Not applicable.

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

Not applicable.

ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANTS

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

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.

We follow the Companies Law, the relevant provisions of which are summarized in Item 10 to this annual report, rather than comply with the NASDAQ requirements relating to: (i) the quorum for adjourned shareholder meetings; (ii) executive sessions of independent directors, which are not required under the Companies Law; (iii) that director nominees either be selected, or recommended for the board's selection, either by independent directors constituting a majority of the board's independent directors or by a nominations committee comprised solely of independent directors, and (iv) shareholder approval with respect to issuance of securities under equity based compensation plans. NASDAQ rules generally require shareholder approval when an equity based compensation plan is established or materially amended, but we follow the Companies Law, which requires approval of the board of directors or a duly authorized committee thereof, unless such arrangements are for the compensation of directors, in which case they also require compensation committee and shareholder approval

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

The Company has elected to provide Financial Statements pursuant to Item 18.

ITEM 18. FINANCIAL STATEMENTS

See pages F-1 through F-39.

ITEM 19. EXHIBITS

Number	Description
<u>1.1</u>	<u>Amended and Restated Articles of Association of the Company amended October 19, 2017 (incorporated by reference to exhibit 99.1 to the Company's 6-K Form filed on September 5, 2017).</u>
1.2	Memorandum of Association of the Company (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form F-1 (registration number 333-05718).
<u>2.1</u>	<u>Form of Ordinary Shares Purchase Warrant of the Company (incorporated by reference to Exhibit 99.3 to the Company's Form 6-K filed on June 14, 2011).</u>
<u>4.1</u>	<u>Employee Agreement between the Company and Izhak Nakar (incorporated by reference to Exhibit 4.1 to the Company's Form 20-F for the year ended December 31, 2012).</u>
<u>4.2</u>	<u>Top Image Systems Ltd. 2003 Amended Option Plan (2013) (incorporated by reference to Exhibit 99.4 to the Company's Form 6-K filed on September 3, 2013).</u>

- 4.4 Form of Director and Officer Indemnification Agreement (incorporated by reference to Exhibit 4.12 to the Company's annual report on Form 20-F for the year ended December 31, 2006).
- 4.5 Securities Purchase Agreement, dated June 6, 2011, among the Company and the purchasers identified on the signature pages thereto (incorporated by reference to Exhibit 99.1 to the Company's Form 6-K filed on June 14, 2011).
- 4.6 Registration Rights Agreement, dated June 13, 2011, among the Company and the purchasers identified on the signature pages thereto (incorporated by reference to Exhibit 99.2 to the Company's Form 6-K filed on June 14, 2011).

Number	Description
<u>4.8</u>	<u>Securities Purchase Agreement dated December 5, 2016 by and between the Company and HCP-FVE, LLC.</u>
<u>4.9</u>	<u>Convertible Note, dated December 5, 2016, issued by the Company to HCP-FVE, LLC.</u>
<u>8</u>	<u>List of Subsidiaries.</u>
<u>12.1</u>	<u>Certification of the principal executive officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>12.2</u>	<u>Certification of the Chief Financial Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
<u>13.1</u>	<u>Certification of the principal executive officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
<u>13.2</u>	<u>Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
<u>15.1</u>	<u>Consent of Kost Forer Gabbay & Kasierer– member of Ernst & Young Global.</u>
<u>15.2</u>	<u>Audit Committee Charter (incorporated by reference to exhibit 14.3 to Company’s annual report on Form 20-F for the year ended December 31, 2003).</u>

Attached as Exhibit 101 to this report are the following Interactive Data Files formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of December 31, 2012 and December 31, 2011; (ii) Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010; (iii) Consolidated Statements of Changes in Shareholders’ Equity for the years ended December 31, 2012, 2011 and 2010; (iv) Consolidated Statement of Cash Flows for the years ended December 31, 2012, 2011 and 2010; and (v) Notes to the Consolidated Financial Statements. Users of this data are advised pursuant to Rule 401 of Regulation S-T that the information contained in the XBRL documents is unaudited and these are not the official publicly filed financial statements of the Company.

Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SIGNATURES

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.

TOP IMAGE SYSTEMS
LTD.

By: /s/ Brendan Reidy
Brendan Reidy
Chief Executive Officer

Date: May 16, 2018

80

TOP IMAGE SYSTEMS LTD

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2017

U.S. DOLLARS IN THOUSANDS

INDEX

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets</u>	F-3 - F-4
<u>Consolidated Statements of Operations</u>	F-5
<u>Consolidated Statements of Comprehensive loss</u>	F-6
<u>Statements of Changes in Shareholders' Equity</u>	F-7
<u>Consolidated Statements of Cash Flows</u>	F-8 - F-9
<u>Notes to Consolidated Financial Statements</u>	F-10 - F-39

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Tel-Aviv 6492102, Israel ey.com

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

TOP IMAGE SYSTEMS LTD.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Top Image Systems Ltd (the "Company") as of December 31, 2017 and 2016, the related consolidated statements of operation, comprehensive loss, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting 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.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

We have served as the Company's auditor since 2003.
Tel-Aviv, Israel
May 16, 2018

TOP IMAGE SYSTEMS LTD.

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2016	2017
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$7,636	\$2,231
Restricted cash	119	220
Trade receivables (net of allowance for doubtful accounts of \$ 1,298 and \$ 361 at December 31, 2016 and 2017, respectively)	6,717	5,226
Other accounts receivable and prepaid expenses	829	1,108
<u>Total</u> current assets	15,301	8,785
LONG-TERM ASSETS:		
Severance pay fund	1,029	638
Restricted deposits	145	163
Long-term deposits and long-term assets	136	77
Property and equipment, net	1,000	793
Intangible assets, net	3,623	2,353
Goodwill	18,405	18,822
<u>Total</u> long-term assets	24,338	22,846
<u>Total</u> assets	\$39,639	\$31,631

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

TOP IMAGE SYSTEMS LTD.

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

	December 31,	
	2016	2017
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term bank loans	\$3,017	\$800
Trade payables	1,237	1,543
Deferred revenues	3,594	3,033
Accrued expenses and other accounts payable	3,430	4,324
<u>Total</u> current liabilities	11,278	9,700
LONG-TERM LIABILITIES:		
Accrued severance pay	1,214	721
Non-current deferred revenues	2,626	1,893
Long-term convertible note	4,388	4,936
Other long-term liabilities	140	212
<u>Total</u> long-term liabilities	8,368	7,762
COMMITMENTS AND CONTINGENT LIABILITIES		
SHAREHOLDERS' EQUITY:		
Share capital -		
Ordinary shares of NIS 0.04 par value -		
Authorized: 125,000,000 shares at December 31, 2016 and 2017; Issued and outstanding:		
17,932,230 and 18,167,066 shares at December 31, 2016 and 2017, respectively	200	203
Additional paid-in capital	63,693	64,487
Accumulated other comprehensive loss	(3,561)	(3,606)
Accumulated deficit	(40,377)	(46,965)
Total parent shareholders' equity	19,955	14,119
Non-controlling interest	38	50
<u>Total</u> shareholders' equity	19,993	14,169
<u>Total</u> liabilities and shareholders' equity	\$39,639	\$31,631

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

TOP IMAGE SYSTEMS LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands (except per share data)

	Year ended December 31,		
	2015	2016	2017
Revenues:			
License	\$7,708	\$5,973	\$5,236
Services	26,083	25,662	24,432
<u>Total</u> revenues	33,791	31,635	29,668
Cost of revenues:			
License	545	701	562
Services	15,593	16,119	16,093
<u>Total</u> cost of revenues	16,138	16,820	16,655
Gross profit	17,653	14,815	13,013
Operating expenses:			
Research and development, net	4,797	4,581	4,997
Selling and marketing	10,894	7,448	6,586
General and administrative	7,492	6,910	6,593
Restructuring related costs	-	1,142	-
Amortization of intangible assets	390	502	613
<u>Total</u> operating expenses	23,573	20,583	18,789
Operating loss	(5,920)	(5,768)	(5,776)
Financial expenses, net	1,145	956	603
Other income, net	4	12	7
Loss before taxes on income	(7,061)	(6,712)	(6,372)
Tax (expenses) Income	(1,215)	115	(204)
Net Loss	\$(8,276)	\$(6,597)	\$(6,576)
Attributes to:			
The Company's shareholders	\$(8,295)	\$(6,610)	\$(6,588)
Non-controlling interests	19	13	12
	\$(8,276)	\$(6,597)	\$(6,576)
Net loss per Ordinary share attributable to the Company's shareholders:			
Basic	\$(0.46)	\$(0.37)	\$(0.37)

Diluted \$(0.46) \$(0.37) \$(0.37)

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

F - 5

TOP IMAGE SYSTEMS LTD.

STATEMENTS OF COMPREHENSIVE LOSS

 U.S. dollars in thousands (except share data)

	Year ended December 31,		
	2015	2016	2017
Net Loss	\$(8,276)	\$(6,597)	\$(6,576)
Foreign currency translation adjustments	(567)	(540)	(45)
Comprehensive Loss	\$(8,843)	\$(7,137)	\$(6,621)
Attributed to:			
Company's Shareholders	\$(8,843)	\$(7,150)	\$(6,633)
Non-controlling interests	19	13	12
Comprehensive Loss	\$(8,824)	\$(7,137)	\$(6,621)

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

 F - 6

TOP IMAGE SYSTEMS LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands (except share data)

	Ordinary shares		Additional paid-in capital	Accumulated other comprehensive loss		Accumulated deficit	Total	Non controlling Interest	Total Equity
	Number	Amount		loss	deficit				
Balance at January 1, 2015	17,823,959	\$ 198	\$ 61,559	\$ (2,454)	\$ (25,472)	\$ 33,831	\$ 6	\$ 33,837	
Exercise of warrants and stock options	95,167	1	189	-	-	190	-	190	
Other comprehensive loss	-	-	-	(567)	-	(567)	-	(567)	
Share-based compensation expenses	-	-	808	-	-	808	-	808	
Net loss	-	-	-	-	(8,295)	(8,295)	19	(8,276)	
Balance at December 31, 2015	17,919,126	199	62,556	(3,021)	(33,767)	25,967	25	25,992	
Exercise of warrants and stock options	13,104	1	17	-	-	18	-	18	
Other comprehensive loss	-	-	-	(540)	-	(540)	-	(540)	
Share-based compensation expenses	-	-	1,120	-	-	1,120	-	1,120	
Net loss	-	-	-	-	(6,610)	(6,610)	13	(6,597)	
Balance at December 31, 2016	17,932,230	\$ 200	\$ 63,693	\$ (3,561)	\$ (40,377)	\$ 19,955	\$ 38	\$ 19,993	
Issuance of Ordinary shares	234,836	3	(3)	-	-	-	-	-	
Other comprehensive loss	-	-	-	(45)	-	(45)	-	(45)	
Share-based compensation expenses	-	-	797	-	-	797	-	797	
Net loss	-	-	-	-	(6,588)	(6,588)	12	(6,576)	
Balance at December 31, 2017	18,167,066	\$ 203	\$ 64,487	\$ (3,606)	\$ (46,965)	\$ 14,119	\$ 50	\$ 14,169	

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

TOP IMAGE SYSTEMS LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended		
	December 31,		
	2015	2016	2017
<u>Cash flows from operating activities:</u>			
Net Loss	\$(8,276)	\$(6,597)	\$(6,576)
Adjustments to reconcile net loss to net cash provided by in operating activities:			
Share-based compensation expenses	808	1,120	797
Depreciation and amortization	1,876	2,103	1,974
Accrued severance pay, net	63	(21)	(102)
Loss from sale of property and equipment, net	-	-	5
Decrease in long term assets	61	69	63
Decrease in deferred tax assets, net	820	-	-
Decrease in trade receivables, net	2,015	2,456	1,496
Increase (decrease) in interest pay	-	17	(17)
Increase (decrease) long term liabilities	(40)	(301)	620
Decrease (increase) in other accounts receivable and prepaid expenses	(184)	51	(246)
Increase (decrease) in trade payables	41	(96)	236
Increase (decrease) in deferred revenues	655	104	(1,480)
Increase (decrease) in accrued expenses and other accounts payable	1,121	(866)	609
Net cash used in operating activities	(1,040)	(1,961)	(2,621)
<u>Cash flows from investing activities:</u>			
Decrease (increase) in restricted deposits	48	145	(119)
Increase in long term deposits	(23)	(2)	-
Purchase of property and equipment	(905)	(225)	(493)
Business acquired	(216)	-	-
Net cash used in investing activities	(1,096)	(82)	(612)

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

TOP IMAGE SYSTEMS LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2015	2016	2017
<u>Cash flows from financing activities:</u>			
Proceeds from exercise of Warrants and stock options	190	18	-
Change in other long term convertible note	-	4,422	-
Decrease (increase) in short term bank borrowings	77	2,923	(2,200)
Net cash provided (used) by financing activities	267	7,363	(2,200)
Effect of exchange rate on cash and cash equivalent balances	(113)	(88)	28
Increase (decrease) in cash and cash equivalents	(1,982)	5,232	(5,405)
Cash and cash equivalents at the beginning of the year	4,386	2,404	7,636
Cash and cash equivalents at the end of the year	\$2,404	\$7,636	\$2,231

Supplemental disclosure of cash flows activities:Cash paid during the year for:

Taxes	\$14	\$72	\$118
Interest	\$107	\$143	\$165

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

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 1: GENERAL

a. Business and organization:

Top Image Systems Ltd. and its subsidiaries (collectively the "Company" or "TIS") are engaged in the development and marketing of a variety of information recognition systems and technologies and automated document capture solutions for the efficient flow of information within and between organizations. The Company's software minimizes the need for manual data entry by automatically capturing, reading, understanding, identifying, processing, classifying and routing the information contained in documents, increasing data capture accuracy and the rate of information processing.

The Company operates in one reportable segment and its revenues are mainly derived from two sources: (i) license revenue and (ii) services revenue which include Software as a Services ("SaaS"), professional services, maintenance and technical support.

The Company has one customer that accounts for more than 10% of revenues.

The Company's shares are traded on the NASDAQ Stock Market LLC in the United States.

The Company's main marketing and sales activities are conducted through its wholly owned subsidiaries in the United States, the United Kingdom, Germany, Hong Kong, Japan and Singapore. On June 30, 2014, the Company, b. established a new subsidiary in Australia, Top Image Systems Pty Ltd. (or "TIS Australia"), together with one of its partners.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. ("U.S. GAAP"), applied on a consistent basis, as follows:

a. Use of estimates:

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The Company's management believes that the estimates, judgment and assumptions used are reasonable based upon information available at the time they are made. As applicable to these consolidated financial statements, the most significant estimated and assumptions are employed in estimates used in determining values of stock-based compensation costs, financial instruments with no observable market quotes, as well as in estimates used in applying the revenue recognition policy, allowance for doubtful accounts, income taxes and valuation allowance and contingent liabilities. Actual results could differ from those estimates.

b. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany balances and transactions including profit from intercompany sales not yet realized outside the Company, have been eliminated upon consolidation.

F - 10

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

c. Financial statements in United States dollars:

A substantial portion of the Company's costs is incurred in U.S. dollars ("dollars"). Some of the revenues of the Company are generated in dollars. The majority of the Company's financing is in dollars. The Company's management believes that the dollar is the currency of the primary economic environment in which the Company and certain of its subsidiaries operate. Thus, the functional and reporting currency of the Company and certain of its subsidiaries is dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with ASC 830, "Foreign Currency Matters". All transaction gains and losses of the remeasurement of monetary balance sheet items are reflected in the consolidated statement of comprehensive income (loss) as financial income or expenses, as appropriate.

For those subsidiaries, whose functional currency has been determined to be their local currency, assets and liabilities are translated at year-end exchange rates and statement of income (loss) items are translated at average exchange rates prevailing during the year. Related translation adjustments are recorded as a separate component of accumulated other comprehensive loss in changes in shareholders' equity.

d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash with original maturities of three months or less, at the date acquired.

e. Restricted cash and long-term deposits:

Restricted cash is primarily invested in short term and long-term deposits. For more information, refer to Note 8c.

f. Long – term deposits and long-term assets:

Consist mainly of long-term prepaid expenses for motor vehicle and office leasing.

g. Property and equipment, net:

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

	Years
Computers and peripheral equipment	3
Office furniture and equipment	5 - 16 (mainly 16 years)
Leasehold improvements	Over the shorter of the lease term or useful economic life

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Impairment of long-lived assets:

The Company's long-lived assets are reviewed for impairment in accordance with ASC 360 "Property, Plant and Equipment," whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset (or asset group) to the future undiscounted cash flows expected to be generated by the asset (asset group). 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. The loss is allocated to the long-lived assets of the Company on a pro rata basis using the relative carrying amounts of those assets, except that the loss allocated to an individual long-lived asset of the Company will not reduce the carrying amount of that asset below its fair value whenever that fair value is determinable.

During the years 2015, 2016 and 2017, no impairment losses had been identified for intangible assets and property and equipment.

i. Goodwill:

Goodwill represents the excess of the purchase price in a business combination over the fair value of the net tangible and intangible assets acquired. Under ASC 350, "Intangible - Goodwill and Other," goodwill is not amortized, but rather is subject to an annual impairment test.

ASC 350 requires goodwill to be tested for impairment at the reporting unit level at least annually or between annual tests in certain circumstances and written down when impaired. Goodwill is tested for impairment by comparing the fair value of the reporting unit with its carrying value.

ASC 350 allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If the qualitative assessment does not result in a more likely than not indication of impairment, no further impairment testing is required. If it does result in a more likely than not indication of impairment, the two-step impairment test is performed. Alternatively, ASC 350 permits an entity to bypass the qualitative assessment for any reporting unit and proceed directly to performing the first step of the goodwill impairment test.

The Company operates in one operation-based segment and in one reporting unit. The Company performed a qualitative assessment during the fourth quarter of 2017 and concluded that the qualitative assessment did not result in a more likely than not indication of impairment, and therefore no further impairment testing was required.

During the years 2015, 2016 and 2017, no impairment charge was recognized.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

j. Intangible assets:

Intangible assets are comprised of acquired technology and customer relations. Definite-lived intangible assets are amortized over their estimated useful life. Acquired technology is amortized on a straight-line basis over a period of 3.2 years. Customer relations are amortized using accelerated amortization method over a period of 8.5 years.

k. Revenue recognition:

The Company reports revenues in two categories: license revenue and services revenue. License revenue includes perpetual or term licenses. Service revenue includes cloud services, professional services and post-contract customer support ("PCS"). Our arrangements for license our cloud offerings often contain multiple other elements, including professional services and PCS.

The Company recognizes revenue in accordance with ASC 985-605, "Software Revenue Recognition ("ASC 985-605"), which generally requires revenues earned from software arrangements involving multiple elements to be allocated to each element based on the relative fair values of the elements. Software revenue recognition requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor's specific objective evidence ("VSOE") of fair value exists for those elements. Revenues are allocated using the residual method when a license arrangement includes multiple elements.

Revenue from license fees is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable. PCS revenue is deferred and recognized on a straight-line basis over the term of the agreement. Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement.

For sales that do not included a perpetual software, we recognize revenues in accordance to Accounting Standards Update ("ASU") No. 2009-13, Topic 605 - Multiple-Deliverable Revenue Arrangements ("ASU 2009-13"). ASU 2009-13 requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price.

The selling price for a deliverable is based on its vendor-specific objective evidence ("VSOE") if available, third-party evidence ("TPE") if VSOE is not available, or estimated selling price ("ESP") if neither VSOE nor TPE is available. The Company then recognizes revenue on each deliverable in accordance with its policies for product and service revenue recognition. TPE of selling price is established by evaluating largely interchangeable competitor products or services in stand-alone sales to similarly situated customers. However, as our products contain a significant element of proprietary technology and its solutions offer substantially different features and functionality, the comparable pricing of products with similar functionality typically cannot be obtained.

F - 13

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Additionally, as the Company is unable to reliably determine what competitors' products' selling prices are on a stand-alone basis, the Company is not typically able to determine TPE. The ESP is established considering multiple factors including, but not limited to, pricing practices in different geographical areas and through different sales channels, gross margin objectives, internal costs, competitors' pricing strategies, and industry technology lifecycles. The selling price of the products and professional services was based on ESP.

Deferred revenues represent unearned amounts received by customers and not yet recognized as revenues.

The Company generally does not grant a right of return to its customers.

F - 14

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

l. Cost of Revenue

Our total cost of revenue is comprised of the following:

1. Cost of License Revenue-Cost of license revenue is comprised primarily of third-party license and hardware costs.

2. Cost of Services Revenue-Cost of services revenue is primarily comprised of personnel costs of our technical implementation, support and training teams. Cost of services revenue also includes contractors and facilities costs.

m. Research and development costs:

Research and development costs are charged to the statement of income (loss) as incurred. ASC 985-20 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. Costs incurred by the Company between completion of the working model and the point at which the products are ready for general releases were insignificant. Therefore, all research and development costs have been expensed.

n. Royalty and non-royalty bearing grants:

Royalty-bearing grants from the Government of Israel for funding approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the costs incurred and included as a reduction in research and development costs.

Grants are only recognized once there is reasonable assurance that the Company will comply with conditions attached to the grant and the grant will be received. Such grants are recorded as a reduction on related research and development costs since, when received, those are not probable to be repaid.

o. Accounting for share-based compensation:

At December 31, 2017, the Company has one share-based employee compensation plan, which is described extensively in Note 11.

The Company accounts for share-based compensation in accordance with ASC 718, "Stock Compensation" ("ASC 718"). ASC 718 requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. 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 statement of Comprehensive income (loss).

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company recognizes compensation expenses for the value of its awards, which have graded vesting based on the straight-line method over the requisite service period of each of the awards, net of estimated forfeitures. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The Company estimates the fair value of stock options granted using the Monte-Carlo simulation option-pricing model. The Monte-Carlo Simulation for option pricing requires a few assumptions, of which the most significant are the suboptimal exercise factor and expected stock price volatility. The suboptimal exercise factor is estimated using historical option exercise information. The suboptimal exercise factor is the ratio by which the stock price must increase over the exercise price before employees are expected to exercise their stock options. The expected life of employee options is a derived output of this assumption from the Monte-Carlo Simulation.

Expected volatility is based upon actual historical stock price movements over the most recent periods. Expected volatility is calculated as of the grant dates for different periods, since the Monte-Carlo Simulation is used for different expected volatilities for different periods.

The Company has historically not paid dividends. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term and calculated for different periods that are in line with the expected volatility periods.

The fair value of the Company's stock options granted to employees and directors was estimated using the following assumptions:

	Year ended December 31,		
	2015	2016	2017
Dividend yield	0%	0%	0%
Expected volatility	36%-69%	40%-86%	53%-84%
Risk-free interest rate	0.26%-2.30%	0.52%-2.55%	1.09%-2.35%
Contractual term of up to	10 years	10 years	10 years
Suboptimal exercise multiple- employees	2.50	2.60	1.88
Suboptimal exercise multiple- management	2.50-2.60	3.00	2.29

The Company applies ASC 718 and ASC 505-50, "Equity-Based Payments to Non-Employees" with respect to options and warrants issued to non-employees. Accordingly, the Company uses Geometric Brownian Motion Model valuation in a Monte Carlo Simulations measure the fair value of the options and warrants at the measurement date as defined in ASC 505-50.

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

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Diluted net loss per share is computed by giving effect to all potential shares of common stock, including stock options, convertible preferred stock warrants stock, to the extent dilutive.

Basic and diluted net loss per share was the same for each period presented as the inclusion of all potential shares of common stock outstanding would have been anti-dilutive.

q. Income taxes:

The Company accounts for income taxes in accordance with Accounting Standards Codification No. 740, using the liability method whereby deferred tax assets and liability account balances are determined based on the differences between financial reporting and the tax basis for 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 the amounts that are more likely-than-not to be realized.

ASC 740 contains a two-step approach to recognizing and measuring a liability for uncertain tax positions. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. The Company accrues interest and penalties related to unrecognized tax benefits in its taxes on income.

r. Concentrations of credit risk:

Financial instruments which potentially subject the Company to concentration of credit risk consist principally of cash and cash equivalents, restricted cash and trade receivables.

The Company's cash, cash equivalents and restricted deposits are invested primarily in deposits with major banks worldwide; however, such cash and cash equivalents in the US may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are institutions with high credit standing, and accordingly, low credit risk exists with respect to these investments.

Trade receivables of the Company are derived from sales to customers located primarily in the U.S., Europe, Japan, and the Far East. The Company performs ongoing credit evaluations of its customers. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

s. Severance pay:

The Company's liability for severance pay is calculated pursuant to Israel's Severance Pay Law, 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 employees in Israel is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

The deposited funds 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.

The Company has also defined contribution plans to some of its employees pursuant to section 14 to the Severance Pay Law under which the Company pays fixed contributions and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient amounts to pay all employee benefits relating to employee service in the current and prior periods.

Severance expenses for the years ended December 31, 2015, 2016 and 2017 amounted to approximately \$ 295, \$ 246 and \$ 152, respectively.

t. Fair value of financial instruments:

Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability.

A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2: Observable inputs that reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Unobservable inputs reflecting our own assumptions incorporated in valuation techniques used to determine fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The carrying amounts of cash and cash equivalents, trade receivables, short-term deposits and trade payables approximate their fair value due to the short-term maturity of such instruments.

u. Comprehensive loss:

The Company accounts for comprehensive loss in accordance with ASC No. 220, "Comprehensive Income". Comprehensive income generally represents all changes in shareholders' equity during the period except those resulting from investments by, or distributions to, shareholders. The Company determined that its items of comprehensive loss relate to foreign currency translation adjustments.

v. Contingent liabilities:

The Company accounts for its contingent liabilities in accordance with ASC 450 definition. A provision is recorded when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

With respect to legal matters, provisions are reviewed and adjusted to reflect the impact of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. As of December 31, 2017, the Company is not a party to any litigation that could have a material adverse effect on the Company's business, financial position, results of operations or cash flows.

w. Allowance for doubtful accounts:

The Company maintains an allowance for doubtful accounts for estimated losses inherent in its trade receivable portfolio. In establishing the required allowance, management bases its determination, among other factors, on information available about the debtors' financial situation, the volume of their operations and evaluation of the security received from them. Account balances are charged against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

x. Recently Issued Accounting Pronouncements:

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"), which amends the existing accounting standards for revenue recognition. The core principle of the ASU is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. ASU 2014-09 requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. The Company adopted the ASU 2014-09 on January 1, 2018, using the modified retrospective method of adoption. The Company is substantially complete with its evaluation of the impact of adopting ASU 2014-09 on its consolidated financial statements and does not expect significant changes in the timing or method of its revenue recognition. The Company has identified and implemented changes to its accounting processes and controls to support the new revenue recognition and disclosure requirements.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In March 2016, the FASB issued ASU 2016-09, "Compensation – Stock Compensation", which effects all entities that issue share-based payment awards to their employees. The amendments in this ASU cover such areas as the recognition of excess tax benefits and deficiencies, the classification of those excess tax benefits on the statement of cash flows, an accounting policy election for forfeitures, the amount an employer can withhold to cover income taxes and still qualify for equity classification and the classification of those taxes paid on the statement of cash flows. This ASU was effective for annual and interim periods beginning after December 15, 2016.

The Company has determined that adoption of this method will have no material influence on the financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases" (Topic 842), which requires lessees to record a right-of-use asset and a lease liability on their balance sheets.

Topic 842 supersedes the previous leases standard, ASC 840, "Leases". The guidance is effective for the interim and annual periods beginning on or after December 15, 2018, and early adoption is permitted. The Company has elected not to early adopt this standard. The Company expects that most of its operating lease commitments will be subject to Topic 842 and will be recognized as right-of-use assets and lease liabilities upon adoption with no material impact on its results of operations or cash flows.

F - 20

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment. ASU 2017-04 removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This standard, which will be effective for the Company beginning in the first quarter of fiscal year 2021, is required to be applied prospectively. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company has decided not to early adopt this standard and is currently evaluating the ASU to determine the impact of its adoption on the financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force). ASU 2016-18 requires that the statement of cash flows provides the change in the total of cash, cash equivalents, and restricted cash or restricted cash equivalents. This will result in us no longer showing the changes in restricted cash balances as a component of cash flows from financing activities but instead include the balances of both current and long-term restricted cash with cash and cash equivalents in total cash, cash equivalents and restricted cash for the beginning and end of the periods presented. The ASU will become effective in the first quarter of fiscal year 2018, early adoption is permitted. The Company has determined that adoption of this method will have no material influence on the financial statements.

NOTE 3: OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2016	2017
Government authorities	\$45	\$83
Prepaid expenses	700	768
Rent and motor leasing deposits	31	32
Others	53	225
	\$829	\$1,108

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 4: PROPERTY AND EQUIPMENT

	December 31,	
	2016	2017
Cost:		
Computers and peripheral equipment	\$7,385	\$7,876
Office furniture and equipment	1,019	1,092
Leasehold improvements	109	112
	8,513	9,080
Accumulated depreciation:		
Computers and peripheral equipment	6,607	7,243
Office furniture and equipment	816	942
Leasehold improvement	90	102
	7,513	8,287
Depreciated cost	\$1,000	\$793

Depreciation expenses amounted to \$ 641, \$ 668 and \$704 for the years ended December 31, 2015, 2016 and 2017, respectively.

As to charges, see Note 8b.

NOTE 5: INTANGIBLE ASSETS

Intangible assets arose from a 2014 acquisition.

a. Identifiable intangible assets:

	December 31,	
	2016	2017
Original amount:		
Customer relations	\$3,997	\$3,997
Technology	3,005	3,005
	7,002	7,002
Accumulated amortization:		
Customer relations	1,032	1,645
Technology	2,347	3,004
	3,379	4,649

Intangible assets, net \$3,623 \$2,353

b. Amortization expenses amounted to \$ 1,435 and \$ 1,270 for the years ended December 31, 2016 and 2017, respectively.

F - 22

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 5: INTANGIBLE ASSETS (Cont.)

c. Estimated amortization expenses of intangible assets for the year ended:

December 31, assets	Other intangible
2018	649
2019	615
2020	466
2021	354
2022	269
	\$ 2,353

NOTE 6: GOODWILL

The changes in the carrying amount of goodwill for the year ended December 31, 2017 are as follows:

Balance as of January 1, 2016	\$19,091
Foreign currency translation adjustments	(686)
Balance as of December 31, 2016	18,405
Foreign currency translation adjustments	417
Balance as of December 31, 2017	18,822

NOTE 7: ACCRUED EXPENSES AND OTHER ACCOUNTS PAYABLE

	December 31,	
	2016	2017
Employees and payroll accruals	\$255	\$251
Government authorities	621	867
Accrued vacation pay	175	171
Accrued expenses	1,478	2,303
Factoring advance payments	167	120
Capital leases – current portion	271	254
Other	463	358
	\$3,430	\$4,324

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 8: COMMITMENTS AND CONTINGENT LIABILITIES

a. Commitments:

With respect to the participation of the Israeli Government in software research and development costs, the Company is committed to pay to the Government royalties at the rate of 3%-3.5% of revenues from sale of its iCMR software, up to a maximum of 100% of the amount of participation received, linked to the dollar, plus interest at the LIBOR rate.

The Company's total outstanding obligation in respect of royalty-bearing Government participation received or accrued, net of royalties paid or accrued, amounted to \$674 as of December 31, 2017.

The Company has entered into non-cancelable operating lease agreements for the lease of motor vehicles, facilities rental and certain equipment. The leasing deposits are recorded as part of other account receivables.

The Company's facilities are leased under non-cancelable operating lease agreements, which expire on various dates, the latest of which is in 2021.

As of December 31, 2017, the Company is required to make the following minimum lease payments under operating leases for its motor vehicles, rental facilities and certain equipment:

2018	1,183
2019	851
2020	358
2021	178

Total \$2,570

Rental expenses for motor vehicles, facility rental and certain equipment expenses amounted to \$ 1,194, \$ 1,361 and \$ 1,292 for the years ended December 31, 2015, 2016 and 2017, respectively.

In 2016 the Company signed a \$3,000 line of credit agreement with an Israeli bank. The line of credit bore interest at Libor plus 4.2% and was collateralized by the Company's Accounts Receivable. Borrowings under this arrangement was \$3,000 as of December 31, 2016. The line was repaid and cancelled in May 2017.

In 2017 the Company signed a \$2,500 line of credit agreement with an U.S. bank. The line of credit bears interest at Libor plus 2.5% and is collateralized by the Accounts Receivable of the Company's United States subsidiary. Borrowings under this arrangement were \$.8 as of December 31, 2017. As of December 31, 2017 the Company was in compliance with all covenants in the agreement. Subsequent to December 31, 2017, the borrowings under the line were repaid and the line was cancelled.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 8: COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

b. Charges:

To secure compliance with the conditions related to the Company's "Approved Enterprise" status, the Company

1. registered a floating charge on equipment and other assets. The charge is unlimited in amount and it may not be further pledged or transferred without the prior consent of the beneficiaries.

2. To secure revolving credit facilities and guarantees from a bank, the Company recorded a floating charge on its plant, assets and rights and fixed charges on its unpaid share capital and its goodwill in favor of this bank (see also note 8a (3)).

c. Guarantees:

1. The Company has secured some of its lease agreements by a bank guarantee in the amount of \$ 132.

2. The Company provided certain customers and vendors with a \$ 251 bank guarantee.

Legal proceedings:

d. During 2016, a third party that the Company works with sued the Company for alleged comments that they believe the Company made that could lead to a breach of contract. The Company has filed a counter-suit. In March 2018 the parties settled all claims in exchange for a payment of approximately \$389 thousand, which was accrued in the Company's financial statements as of December 31, 2017. Subsequent to December 31, 2017 we paid the third party \$389 thousand in relation to the settlement of all claims.

In August 2017, one of the Company's customers claimed for damages for non-contractual fulfilment. The Company and its attorneys cannot yet assess the possible outcome.

In October 2017 a former executive raised claim regarding his termination from employment. In December 2017 the parties settled all claims in exchange for a payment totaling approximately \$569 thousand to be throughout 2018, which was accrued in the Company's financial statements as of December 31, 2017.

In December 2017, one of the Company's customers claimed for damages, for non-contractual fulfilment. The Company and its attorneys cannot yet assess the possible outcome.

In March 2018, one of the Company's customers claimed for alleged breach of maintenance contact by the Company. The Company and its attorneys cannot yet assess the possible outcome.

Subsequent to December 31, 2017, in March 2018, one of the Company's customers claimed for alleged breach of maintenance contact by the Company. The Company and its attorneys cannot yet assess the possible outcome.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 9: TAXES ON INCOME

a. Israeli income taxes:

1. Measurement of taxable income:

The Company has elected to measure its taxable income and file its tax return under the Israeli Income Tax Regulations (Principles Regarding the Management of Books of Account of Foreign Invested Companies and Certain Partnerships and the Determination of Their Taxable Income), 1986. Accordingly, results for tax purposes are measured in terms of earnings in dollars.

2. The Law for the Encouragement of Capital Investments, 1959 ("the Investment Law"):

In 1990, the production facilities of the Company were granted the status of an "Approved Enterprise" under the Investment Law. In 1991, 1999, 2000, expansion programs were granted the status of "Approved Enterprise" (established plan). According to the provisions of the Law, the Company has elected the alternative package of benefits - and has waived Government grants in return for tax benefits.

According to the provisions of the Investment Law, the Company's income is tax-exempt for a period of two years commencing with the year it first earns taxable income, and subject to corporate taxes at the reduced rate of 10% to 25%, for an additional period of five to eight years (subject to the limitation period of the benefits according the laws) depending upon the level of foreign ownership of the Company.

On April 1, 2005, an amendment to the Investment Law came into effect ("the Amendment") and has significantly changed the provisions of the Investment Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a "Benefited Enterprise", such as provisions generally requiring that at least 25% of the "Benefited Enterprise's" income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits.

However, the Amendment provides that terms and benefits included in any letter of approval already granted will remain subject to the provisions of the Investment Law as they were on the date of such approval. Therefore, investment programs that obtained approval for Approved Enterprise status prior to enactment of the Amendment will continue to be subject to the old provisions of the Investment Law.

The period of tax benefits for a new Benefited Enterprise commences in the "Year of Commencement," which is the later of: (1) the year in which taxable income is first generated by the Company, or (2) the year of election.

The entitlement to the above benefits is contingent upon the fulfillment of the conditions stipulated in the Amendment and regulations published there under. In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest and linked to changes in the Israeli CPI. As of December 31, 2017, the Company believes that it is meeting the aforementioned conditions.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 9: TAXES ON INCOME (Cont.)

The Company elected 2009 as a year of election under the Amendment. The Amendment entitles the Company to a corporate tax exemption for a period of two years and to a reduced corporate tax rate of 10% - 25% (based on the percentage of foreign ownership) for an additional period up to eight years from the first year it has taxable income (the "Benefits period"). The benefits period of the company ends in 2020.

If the Company pays a dividend out of income derived from the Approved and Benefited Enterprise during the tax exemption period, it will be subject to corporate tax in respect of the gross amount distributed, including any taxes thereon, at the rate which would have been applicable had it not enjoyed the alternative benefits, generally 10% - 25%, depending on the percentage of the Company's Ordinary shares held by foreign shareholders.

As of December 31, 2017, the accumulated deficit of the Company does not include tax-exempt profits earned by the Company's "Approved Enterprise" and "Benefited Enterprise".

Income from sources other than the Approved and Benefited Enterprises during the benefit period will be subject to tax at the regular corporate tax rate.

In January 2011, the Israeli Parliament (the Knesset) passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among others, for amendment of the Investment Law. The amendment became effective as of January 1, 2011. According to the amendment, the benefit tracks in the Investment Law were cancelled and a flat tax rate would apply to the Company's entire preferred income. The Company will be able to opt to apply the amendment (the waiver is non-recourse) and from then the uniform corporate tax rate will be 7% in areas in Israel designated as development zone A and 12.5% elsewhere in Israel during 2013, 9% in development zone A and 16% elsewhere in Israel, respectively, in 2014.

A dividend distributed from income which is attributed to a Preferred Enterprise/Special Preferred Enterprise will be subject to withholding tax at source at the following rates: (i) Israeli resident corporation - 0%, (ii) Israeli resident individual - 15% in 2013 and 20% as of 2014 (iii) non-Israeli resident - 15% in 2013 and 20% as of 2014 subject to a reduced tax rate under the provisions of an applicable double tax treaty.

The Company may choose not to apply the above amendment, in which case the Company will remain subject to the Investment Law as in effect prior to the 2011 amendment until the expiration of the Company's current investment programs. The Company is examining the possible effect of the amendment on the financial statements, if at all.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 9: TAXES ON INCOME (Cont.)

In December 2016, an additional amendment to the Law was passed (the "2016 Amendment"), which provides for: (1) A reduction in the tax rate for Preferred Enterprises in Development Zone A from 9% to 7.5%; and, (2) Additional benefits to Preferred Technological Enterprises by reducing the tax rate on preferred Technological Enterprise income (as such is defined in the 2016 Amendment) to 12%. The Company examined the possible effect of the 2016 amendment and at this time does not believe it will elect to apply the 2016 amendment.

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

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, 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, located in Israel, owned by an Industrial Company, whose major activity in a given tax year is industrial production activity. The Company believes it meets all the criteria to be classified as an "industrial company", as defined by the Industry Encouragement Law and, as such, is entitled to certain tax benefits, mainly accelerated depreciation of machinery and equipment, as prescribed by regulations published under the Inflationary Adjustments Law, the right to claim public issuance expenses and amortization of patents and other intangible property rights as a deduction for tax purposes.

4. Corporate tax rates:

Israeli companies are generally subject to corporate tax on their taxable income. As of 2017, the corporate tax rate is 24% (in 2015 and 2016, the corporate tax rate was 26.5% and 25%, respectively). In December 2016, the Israeli Parliament approved the Economic Efficiency Law which reduces the corporate income tax rate to 23% effective from January 1, 2018.

5. According to section 145 of the Israeli Tax Ordinance the Company's tax assessments till and include the year 2012 are considered as final assessments.

b. Carryforward losses:

As of December 31, 2017, Top Image Systems Ltd. has accumulated carryforward losses and capital losses in the amount of \$21,383 and \$1,891, respectively. The losses can be carryforward against relevant taxable income for an indefinite period. Starting 2015, the Company fully depreciated its deferred tax assets for its carry forward net operating losses in Israel.

As of December 31, 2017, the subsidiaries had operating losses carryforwards for tax purposes in the amount of \$ 26,110.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 9: TAXES ON INCOME (Cont.)

As of December 31, 2017, the U.S. subsidiaries had U.S. Federal and State net operating losses carryforwards of approximately \$23,880, which can be carried forward and offset against taxable income for 6 to 20 years. Utilization of U.S. net operating losses may be subject to substantial annual limitations due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state law provisions. As a result, the Company's management believes that annual limitations may result in the expiration of net operating losses before utilization.

c. Non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed according to the tax laws in their respective domiciles of residence. The Company has not made any provisions relating to undistributed earnings of the Company's foreign subsidiaries since the Company has no current plans to distribute such earnings. If earnings are distributed to Israel in the form of dividends or otherwise, the Company may be subject to additional Israeli income taxes (subject to an adjustment for foreign tax credits) and foreign withholding taxes.

d. Loss before taxes on income is comprised as follows:

	Year ended December 31,		
	2015	2016	2017
Domestic	\$(5,453)	\$(6,012)	\$(7,920)
Foreign	(1,608)	(700)	1,548
	\$(7,061)	\$(6,712)	\$(6,372)

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)\

NOTE 9: TAXES ON INCOME (Cont.)

e. Taxes on income (expenses) are comprised as follows:

	Year ended December 31,		
	2015	2016	2017
Current taxes	\$(194)	\$115	\$(204)
Deferred taxes	(1,021)	-	-
	\$(1,215)	\$115	\$(204)
Domestic	\$(1,268)	\$-	\$-
Foreign	53	115	(204)
	\$(1,215)	\$115	\$(204)

f. Deferred taxes:

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows:

	December 31,	
	2016	2017
Carryforward losses	\$12,859	\$14,188
Research and development expenses	547	492
Provision for bad debt	-	16
Accrued severance pay	46	19
Accrued vacation pay	28	22
Deferred tax assets before valuation allowance	13,480	14,737
Deferred tax liability:		
Intangible assets	(1,377)	(894)
Deferred revenues	(62)	(87)
Deferred tax liabilities before valuation allowance	(1,439)	(981)
Net deferred tax assets before valuation allowance	12,041	13,756
Valuation allowance	(12,041)	(13,756)

Net deferred tax assets	\$-	\$-
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F - 30

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 9: TAXES ON INCOME (Cont.)

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that all or some portion of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences are deductible and net operating losses are utilized.

Starting 2015, the Company recorded a full valuation allowance on its deferred tax assets, since it assessed that the deferred tax assets will not be realized during that period.

Based on a consideration of these factors, the Company has established a valuation allowance of \$ 12,041 and \$ 13,756 at December 31, 2016 and 2017, respectively.

The Company does not have a provision for Israeli income taxes on the undistributed earnings of its international subsidiaries since the Company intends to indefinitely reinvest these earnings outside Israel.

g. Reconciliation of the theoretical tax expenses:

The main reconciling item between the statutory tax rate of the Company and the effective tax rate is the recognition of valuation allowances in respect of deferred taxes relating to accumulated net operating losses carried forward among the various subsidiaries worldwide due to the uncertainty of the realization of such deferred taxes, the effect of the "Approved Enterprise" and undetectable expenses related to option expenses and other equity benefits.

F - 31

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 9: TAXES ON INCOME (Cont.)

A reconciliation of the beginning and ending amounts of unrecognized tax benefits in the year ended December 31, 2016 and 2017 are as follows:

Gross unrecognized tax benefits as of January 1, 2016	\$315
Deduction of unrecognized tax benefits	-
Gross unrecognized tax benefits as of December 31, 2016	315
Gross unrecognized tax benefits as of January 1, 2017	315
Increase in tax provisions prior years	183
Increase in tax provisions current year	-
Gross unrecognized tax benefits as of December 31, 2017	498

As of December 31, 2017, there was \$498 of unrecognized income tax benefits that, if recognized, would impact the effective tax rate in the period in which each of the benefits is recognized.

NOTE 10: LONG-TERM CONVERTIBLE NOTE

On December 5, 2016, the Company entered into a convertible note agreement with a new investor (“Investor”), in the amount of \$4,388 net of issuance expenses in the amount of \$612. The note has a term of four years with a maturity date of December 5, 2020, should it not be converted before that time. The note shall accrue interest equal to the prime rate, as published by the Wall Street Journal plus 2.5%, if being paid in cash, or 3% if payment is made in securities of the Company’s, per year. The Company bares sole discretion as to how it shall pay interest. The interest will be compounded quarterly so long as it is unpaid, and the loan is unconverted. Conversion to Preferred Shares is dependent on the filing of the amendment of the Article of Association ("AOA"), to include a new class of preferred shares of the Company, by the shareholders. The shareholders approved the revised Articles of Association during the annual shareholders meeting in October 2017. As of March 31, 2018, the preferred shares have not been issued and the note has not been converted into preferred shares. It is not known when or if the conversion will occur.

The Investor has the option to convert any or all Preferred Shares into Ordinary Shares. The number of Ordinary Shares issuable upon conversion of Preferred Shares will be equal to the Stated Value (the Conversion Price of the Note on the date of the exchange of the Note for the Initial Preferred Shares), multiplied by the number of Preferred Shares to be converted, divided by the Conversion Price (\$1.776, as adjusted). In no conversion situation may the holder hold more that 9.99% of the outstanding Ordinary Shares.

If at any time after, the Closing Price is 250% greater than the Conversion Price for at least 45 consecutive Trading Days then the Company may elect to require the Investor to convert a portion or all of their outstanding Preferred Shares into Ordinary Shares. The Company is required by the SPA to file a “shelf” registration statement with the SEC. The “shelf” registration statement has not yet been filed and the Company does not know when it will be filed. Since the “shelf” registration statement has not been filed, the Mandatory Conversion Commencement Date shall be extended until the registration statement is effective.

Subsequent to December 31, 2017, the Company entered into a binding commitment with the Investor which provides for a new credit facility, as described more fully in NOTE 16: SUBSEQUENT EVENTS. Upon drawing of the funds of the credit facility, the \$5,000 in convertible notes, plus accrued interest, will be exchanged for the second lien term loans provided for in the Term Sheet and the convertibility to convertible preferred shares will be cancelled.

F - 32

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 11: SHAREHOLDERS' EQUITY

a. Dividends:

Dividends may be paid by the Company only out of the Israeli company's earnings and other surpluses in Israeli currency as defined in the Companies Law as of the end of the most recent fiscal year or as accrued over a period of the last two years whichever is higher. Such dividends will be declared and paid in New Israeli Shekels. No dividends were declared in the periods presented.

b. Employee Stock Option Plan (2003):

The Employee Stock Option Plan (2003) ("the ESOP 2003") is designed to benefit from, and is made pursuant to, the provisions of Section 102 of the Israeli Income Tax Ordinance.

In May 2004, December 2006 and October 2013, the Board of Directors and the shareholders of the Company approved the additional pool of options to purchase additional 650,000, 700,000 and 1,100,000 Ordinary shares, respectively, pursuant to the ESOP 2003.

c. Employee Stock Option Plan (2016):

The Employee Stock Option Plan (2016) ("the ESOP 2016") is designed to benefit from, and is made pursuant to, the provisions of Section 102 of the Israeli Income Tax Ordinance.

In December 2016, the Board of Directors and the shareholders of the Company approved the additional pool of options to purchase additional 2,193,396 Ordinary shares, respectively, pursuant to the ESOP 2016.

During the year ended December 31, 2016, the Company's Board of Directors approved the grant of 736,654 options and 563,655 RSUs to certain employees, officers and directors of the Company. The options were granted at an exercise price range between \$1.66 to \$2.55 per share. Such options and RSUs have vesting schedules of between 1 to 3 years.

During the year ended December 31, 2016, the Company's Board of Directors approved the grant of 20,000 options to an external consultant of the Company. The options were granted at an exercise price of \$1.55 per share. Such options have vesting schedules of between 1 to 2 years.

During the year ended December 31, 2017, the Company's shareholders approved the grant of 25,000 options each to the members of the Board of Directors and. The options were granted at an exercise price of \$1.29 per share and vest between 1 to 2 years.

During the year ended December 31, 2017, the Company's Board of Directors approved the grant of 545,809 options and 163,563 RSU's to certain employees and officers of the Company. The options were granted at an exercise price range between \$1.26 and 1.29 per share. Such options have vesting schedules of between 1 to 2 years.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 11: SHAREHOLDERS' EQUITY (Cont.)

As of December 31, 2017, an aggregate amount of 1,722,279 options are still available for future grant under of the above-mentioned plan.

As of December 31, 2017, 3,119,293 options and RSU's are outstanding.

d. Repricing:

On August 3, 2016, the board of directors approved the repricing of all unvested options as of that date, to an exercise price of \$ 2.11. The number of options and the vesting terms for the repriced options remained unchanged. The Company accounted for the effect of the amendment on its outstanding options as a modification under the provisions of ASC 718, and recorded an additional expense in the amount of \$56 in 2016.

e. The following is a summary of the Company's stock options granted to employees among the various plans:

	Year ended December 31, 2017		Weighted average remaining contractual life (years)	Aggregate intrinsic value
	Number of options	Weighted average exercise price		
Outstanding at the beginning of the year	2,323,760	\$ 2.89	7.63	\$ 0
Granted	545,809	1.27		
Exercised	0	0		
Forfeited	(246,999)	2.64		
Outstanding at the end of the year	2,622,570	\$ 2.58	6.95	\$ -
Exercisable at the end of the year	1,608,833	\$ 2.79	5.63	\$ -
Vested and expected to vest at end of year	2,551,505	\$ 2.29	6.96	\$ -

The aggregate intrinsic value in the table above represents the total intrinsic value that would have been received by the option holders had all option holders exercised their options on the last date of the exercise period. Total intrinsic value of options exercised for the year ended December 31, 2017 was \$ 0. As of December 31, 2017, there was \$ 1,204 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2003 and 2017 Stock Plans. This cost is expected to be recognized over a period of approximately 2.75 years.

The weighted average grant date fair values of options granted during 2016 and 2017 were \$ 0.93 and \$ 0.76, respectively.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 11: SHAREHOLDERS' EQUITY (Cont.)

The following is a summary of the Company's stock options granted to non-employees plan:

Issuance Date	Year ended December 31, 2017		Option exercisable (number)	Exercisable through
	Options of shares of common stock (number)	Exercise price per share		
May 2016	20,000	1.55	-	-

The options outstanding as of December 31, 2017, have been separated into ranges of exercise price as follows:

Range of exercise price	Options Outstanding as of December 31, 2017	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable as of December 31, 2017	Weighted average exercise price of options exercisable
\$ 1.30	585,809	8.98	1.28	40,000	1.30
\$ 1.55 - \$ 2.25	1,442,145	6.85	1.93	968,542	2.01
\$ 3.30 - \$ 6.04	614,616	5.25	4.14	600,291	4.16
	2,642,570	6.95	2.58	1,608,833	2.79

f. Restricted Stock Units ("RSUs")

During 2016, the Company updated their Stock Option Plan to include RSUs.

In 2016 and 2017, the Company issued RSU's totaling 563,654 and 163,563, respectively. One third of the 563,654 RSUs issued in 2016, were exercised on August 23, 2017.

As of December 31, 2017, 492,381 RSUs were outstanding with an aggregate amount of 194,048 RSUs still available for future grants under of the above-mentioned plan.

The following is a summary of the Company's RSUs granted:

Number of Shares	Weighted- Average
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	Underlying Outstanding Restricted Stock Units	Grant Date Fair Value
Outstanding as of January 1, 2017	563,654	1.22
Granted	163,563	1.35
Exercised	(234,836)	-
Forfeited	-	-
Unvested as of December 31, 2017	492,381	\$ 1.26

F - 35

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 11: SHAREHOLDERS' EQUITY (Cont.)

During the years ended December 31, 2015, 2016 and 2017, the Company recognized share-based compensation expense related to employee and consultant, in the amount of \$ 808, \$1,120 and \$ 797, respectively, as follows:

	Year ended December 31,		
	2015	2016	2017
Cost of revenues	\$150	\$211	\$107
Research and development, net	90	127	89
Selling and marketing	198	243	94
General and administrative	370	539	507
Total share-based compensation expense	\$808	\$1,120	\$797

NOTE 12: GEOGRAPHICAL INFORMATION AND MAJOR CUSTOMERS DATA

a. Business segment, geographical areas and foreign operations:

The Company applies ASC 280, "Segment Reporting". The Company manages its business on the basis of one reportable segment (see Note 1 for a brief description of the Company's business). Total revenues are attributed to geographic areas based on the location of the customers.

b. Geographical information :

1. Revenues:

	Year ended December 31,		
	2015	2016	2017
<u>License Revenues</u>			
Far East	\$1,433	\$1,736	\$2,730
Germany	2,421	1,099	1,058
Rest of Europe	2,127	922	877
North and South America	1,343	1,961	339
Africa and Middle East	384	255	231
	7,708	5,973	5,236
<u>Service Revenues</u>			
Far East	3,837	4,191	3,692
Germany	4,881	4,164	3,957
Rest of Europe	4,658	4,016	3,674

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North and South America	12,270	12,847	12,808
Africa and Middle East	437	444	296
	26,083	25,662	24,427
Total revenues	\$33,791	\$31,635	\$29,663

F - 36

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 12: GEOGRAPHICAL INFORMATION AND MAJOR CUSTOMERS DATA (Cont.)

2. The following is a summary of long-lived assets within geographic areas based on the assets' locations:

	Year ended December 31,	
	2016	2017
Israel	\$ 110	\$ 75
USA	737	589
Other	153	129
Total Long-lived assets:	\$ 1,000	\$ 793

NOTE 13: BASIC AND DILUTED NET EARNINGS (LOSS) PER SHARE

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

	Year ended December 31,		
	2015	2016	2017
Net loss used for the computation of diluted net loss per share	\$(8,295)	\$(6,610)	\$(6,586)
Weighted average Ordinary shares outstanding	17,870,588	17,925,684	18,006,776
Effect of dilutive securities:			
Employees stock options	*) -	*) -	*) -
Warrants	*) -	*) -	*) -
	-	-	-
Diluted weighted average Ordinary shares outstanding	17,870,588	17,925,684	18,006,776
Basic loss per Ordinary share	\$(0.46)	\$(0.37)	\$(0.37)
Diluted loss per Ordinary share	\$(0.46)	\$(0.37)	\$(0.37)

*) Anti-dilutive.

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 14: FINANCIAL EXPENSE

	Year ended December 31,		
	2015	2016	2017
Interest expenses	\$ 107	\$ 143	\$ 691
Fair value adjustments for deferred revenues	109	66	-
Exchange rate loss	828	630	(146)
Bank charges	101	117	58
	\$1,145	\$956	\$603

NOTE 15: RELATED PARTY TRANSACTION

According to the Company's agreement with Izhak Nakar, the previous chairman of the board, in consideration for his services to the Company worldwide, the chairman of the board will be entitled to compensation in the amount of US \$ 28.1 plus VAT per month ("the consulting fees"). This amount was reduced to US \$ 25.3 plus VAT per month, during the months of April to December 2016. The arrangement expired in June 2017.

During 2015, 2016, 2017 the previous chairman of the board has been entitled to compensation, including the bonus, on the amount of \$323, \$359 and \$197, respectively for his consulting fees.

F - 38

TOP IMAGE SYSTEMS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 16: SUBSEQUENT EVENTS

In May 2018, in order to provide the Company with additional liquidity if needed, The Company entered into term sheet (“Term Sheet”) with the an affiliate of the Investor which provides for a new senior secured term loan of up to \$3,000 (“Senior Loan”) as part a secured credit facility (“Credit Facility”) that would include the existing convertible notes held by an affiliate of the Investor in an amount of \$5,600. The Senior Loan would include monthly repayments of \$50 in 2019 and \$100 from January 2020 through maturity (such amount to increase on the happening of certain events), an interest rate of Prime plus 5% payable monthly and a 36-month term. In connection with the Credit Facility the Company will issue 10-year warrants to purchase the number of the Company’s ordinary shares equal to 40% of the total Credit Facility divided by the market price. The warrants will have an exercise price equal to the market price of the ordinary shares plus 15%. The Credit Facility will be secured by the Company’s assets and will be guaranteed by each of the Company’s subsidiaries, subject to certain limitations. The Senior Loan would be required to the prepaid on certain events and would be prepayable at the Company’s option at a premium beginning one year following closing.

The Company has not yet determined if it will draw on the Credit Facility. The issuance of the warrants and the changes to the Convertible Note are conditioned upon the drawing the funds of the Credit Facility.

In December 2017, the Company secured a \$2.5 million line of credit with a U.S. based bank. The line was secured by the accounts receivables of our U.S. subsidiary and bore interest at 2.5% or 3% (if in stream line mode) per annum and matured in December 2018. The Company had borrowings outstanding of \$0.8 million against the line of credit at December 31, 2017. Subsequent to December 31, 2017, the borrowings under the line were repaid and the line was cancelled.

F - 39
