MER TELEMANAGEMENT SOLUTIONS LTD
Form 20-F
March 12, 2014

SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 20-F

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

For the fiscal year ended December 31, 2013

OR

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

For the transition period from _____ to _____

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

Date of event requiring this shell company report.....

Commission file number: 0-28950

MER TELEMANAGEMENT SOLUTIONS LTD.
(Exact Name of Registrant as specified in its charter
and translation of Registrant's name into English)

Israel
(Jurisdiction of incorporation or organization)

14 Hatidhar Street, Ra'anana 4366516, Israel
(Address of principal executive offices)

Alon Mualem (Chief Financial Officer), +972-9-7777-555 (phone), +972-9-7777-566 (fax)
14 Hatidhar Street, Ra'anana 4366516, Israel
(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, NIS 0.01 Par Value	NASDAQ Capital Market

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

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

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

Ordinary Shares, par value NIS 0.01 per share……4,655,557
(as of December 31, 2013)

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

Yes o No x

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

Yes o No x

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

Yes x No o

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 (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

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 o Accelerated filer o Non-accelerated filer x

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

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

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 o Item 18 o

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 o No x

This Report on Form 20-F is incorporated by reference into our Form S-8 Registration Statements File Nos. 333-123321 and 333-180369.

INTRODUCTION

Mer Telemanagement Solutions Ltd. is a worldwide provider of solutions for telecommunications expense management, or TEM, used by enterprises, and billing solutions used by information and telecommunication service providers. Our TEM solutions assist enterprises and organizations to make smarter choices with their telecommunications spending at each stage of the service lifecycle, including allocation of cost, proactive budget control, fraud detection, processing of payments and spending forecasting. Our converged billing solutions have been successfully implemented worldwide by wireless providers, Voice over Internet Protocol, Internet Protocol Television, and content service providers. Our converged billing solutions include applications for charging and invoicing customers, interconnect billing and partner revenue management using pre-pay and post-pay schemes, as well as a managed service for a mobile virtual network operator in the United States.

Since our public offering in May 1997, our ordinary shares have been listed on the NASDAQ Stock Market (symbol: MTSL) and are presently listed on the NASDAQ Capital Market. As used in this annual report, the terms "we," "us" and "our" mean Mer Telemanagement Solutions Ltd. and its subsidiaries, unless otherwise indicated. As used in this annual report, "MTS IntegraTRAK" means MTS IntegraTRAK Inc., our wholly-owned U.S. subsidiary.

We own U.S. trademark rights for TABS by MER®, CALLTRAC®, ANCHORPOINT®, MAP-TO-WIN® and TOTAL-e™ and have common law rights in the trademarks TABS.IT, PMSI, TELSOFT SOLUTIONS, TELSOFT, MEGACALL and CALLTRAC LITE, based on use of the marks in the United States. All other trademarks and trade names appearing in this annual report are owned by their respective holders.

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

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any registration statement or annual report that we previously filed, you may read the document itself for a complete description of its terms.

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

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following selected consolidated financial data for and as of the five years ended December 31, 2013 are derived from our audited consolidated financial statements, which have been prepared in accordance with U.S. GAAP. Our audited consolidated financial statements for the three years ended December 31, 2013 and as of December 31, 2012 and 2013 appear elsewhere in this Annual Report. Our selected consolidated financial data as of December 31, 2009 and 2010 and for the year ended December 31, 2010 have been derived from audited consolidated financial statements not included in this Annual Report. The selected consolidated financial data set forth below should be read in conjunction with and are qualified entirely by reference to Item 5. “Operating and Financial Review and Prospects,” and our consolidated financial statements and notes thereto included elsewhere in this annual report.

Statement of Operations Data:

	Year Ended December 31,				
	2009*	2010*	2011	2012	2013
	(in thousands, except share and per share data)				
Revenues	$11, 360	$11,639	$12,003	$13,126	$12,472
Cost of revenues	3,777	4,201	3,941	4,494	4,024
Gross profit	7,583	7,438	8,062	8,632	8,448
Selling and marketing	2,863	2,584	1,905	2,457	2,164
Research and development, net	1,888	1,547	1,909	1,329	1,389
General and administrative	3,618	3,016	3,847	2,804	3,188
Operating income (loss)	(786)	291	401	2,042	1,707
Financial (expenses) income, net	(31)	--	2	60	61
Capital gain on sale of long-term investment	--	--	78	--	--
Income (loss) before taxes on income	(817)	291	481	2,102	1,768
Taxes on income, net	20	47	10	736	435
Net income (loss) from continuing operations	$(837)	$244	$471	1,366	1,333
Net income (loss) from discontinued operations	(40)	(68)	(84)	-	73
Net income (loss)	$(877)	$176	$387	1,366	1,406
	$(0.19)	$0.05	$0.11	$0.30	$0.28

Basic and diluted net income (loss) per share from continuing operations					
Basic and diluted net income (loss) per share from discontinued operations	$(0.01)	$(0.01)	$(0.02)	--	$0.02
Basic and diluted net income (loss) per share	$(0.20)	$0.04	$0.09	$0.30	$0.30
Weighted average number of ordinary shares used in computing basic net income (loss) per share	4,458,976	4,459,057	4,459,057	4,478,677	4,659,230
Weighted average number of ordinary shares used in computing diluted net income (loss) per share	4,458,976	4,459,057	4,459,057	4,531,384	4,720,966

_____

* In March 2009, we discontinued the operations of TABS Brazil Ltda. Accordingly, TABS Brazil Ltda.'s results of operations were classified as discontinued operations and the results of operations for the year ended December 31, 2009 has been reclassified accordingly.

Balance Sheet Data:

	As of December 31,				
	2009	2010	2011	2012	2013
	(in thousands)				
Working capital (deficiency)*	$(1,825)	$(1,129)	$(317)	$1,659	$3,455
Total assets*	9,890	9,607	9,734	11,124	12,629
Shareholders' equity	3,115	3,363	3,832	5,569	7,161

_____

* In March 2009, we discontinued the operations of TABS Brazil Ltda. and the balance sheet data of the liabilities attributable to such discontinued operations have been excluded from working capital (deficiency) and total assets.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Investing in our ordinary shares involves a high degree of risk and uncertainty. You should carefully consider the risks and uncertainties described below before investing in our ordinary shares. If any of the following risks actually occurs, our business, prospects, financial condition and results of operations could be harmed. In that case, the value of our ordinary shares could decline, and you could lose all or part of your investment.

Risks Relating to Our Business and Market

If we do not replace the revenues generated by Simple Mobile LLC our operations and financial condition will be adversely affected.

Our principal customer during the three years ended December 31, 2013 was Simple Mobile LLC, a U.S.-based mobile virtual network operator, or MVNO, for whom we provided hosted billing services. In 2011, 2012 and 2013, sales attributable to this MVNO accounted for approximately 16.4%, 22.8% and 33.3% of our revenues, respectively. During 2012, Simple Mobile was acquired by TracFone and in 2013 TracFone migrated our hosted billing services to its own platform and did not renew its agreement with us, which ended in December 2013. If we are unable to replace the revenues generated by Simple Mobile LLC, our operating results and financial condition will be adversely affected.

We have had operating losses in the past and may not sustain profitability in the future; to the extent that we incur operating losses, we may not have sufficient working capital to fund our operations in the future.

While we have generated operating profits in the past three years, we may not be able to sustain profitable operations in the future or generate positive cash flows from operations. To the extent that we incur operating losses in the future or are unable to generate free cash flows from our business, we may not have sufficient working capital to fund our operations in the future. If we do not generate sufficient cash from operations, we will be required to obtain additional financing or reduce level of expenditure. Such financing may not be available in the future, or, if available, may not be on terms satisfactory to us. If adequate funds are not available to us, our business, and results of operations and

financial condition will be adversely affected.

We derive the majority of our revenues from TEM call accounting solutions, the market for which has declined in recent years.

The majority of our revenues are derived from our TEM call accounting solutions, whose revenues declined each year from 2006 through 2013 and revenues for these products may not grow in the future. If the market for our TEM solutions fails to grow or stabilize in the future, our business, operating results and financial condition would be adversely affected. Our future financial performance will be dependent to a substantial degree on the successful introduction, marketing and customer acceptance of our TEM call accounting solutions.

We are subject to risks associated with rapid technological change and risks associated with new versions and new products.

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

Our results may be adversely affected by intense competition.

The market for telemanagement products and invoice management solutions is fragmented and is intensely competitive. Competition in the industry is generally based on product performance, depth of product line, technical support and price. We compete both with international and local competitors (including providers of telecommunications services), many of whom have significantly greater financial, technical and marketing resources than us. We anticipate continuing competition in the telemanagement products and invoice management solution market and the entrance of new competitors into the market. Our existing and potential customers, including business telephone switching system manufacturers and vendors, may be able to develop telemanagement products and services that are as effective as, or more effective or easier to use than, those offered by us. Such existing and potential competitors may also enjoy substantial advantages over us in terms of research and development expertise, manufacturing efficiency, name recognition, sales and marketing expertise and distribution channels. We may not be able to compete successfully against current or future competitors and that competition may adversely affect our future revenues and, consequently, on our business, operating results and financial condition.

We are subject to risks relating to proprietary rights and risks of infringement.

We believe that, because of the rapid pace of technological change in the communications industry, the most significant factors in our intellectual property rights are the knowledge, ability and experience of our employees, the frequency of product enhancements and the timeliness and quality of support services provided by us. In addition, we rely upon a combination of security devices, copyrights, trademarks, patents, trade secret laws, confidentiality procedures and contractual restrictions to protect our rights in our products. We try to protect our software,

documentation and other written materials under trade secret and copyright laws, which afford only limited protection. It is possible that others will develop technologies that are similar or superior to our technology. Unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. It is difficult to police the unauthorized use of our products, and we expect software piracy to be a persistent problem, although we are unable to determine the extent to which piracy of our software products exists. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. Our means of protecting our proprietary rights in the United States or abroad may not be adequate or our competition may independently develop similar technology.

It is possible that third parties will claim infringement by us of their intellectual property rights. We believe that software product developers will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Any such claims, with or without merits, could: (i) result in costly litigation; (ii) divert management's attention and resources; (iii) cause product shipment delays; or (iv) require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. If there is a successful claim of product infringement against us and we are not able to license the infringed or similar technology, our business, operating results and financial condition would be adversely affected. We are not aware that we are infringing upon any proprietary rights of third parties.

Our operating results fluctuate significantly.

Our quarterly and annual results have fluctuated significantly in the past and are likely to fluctuate significantly in the future. Our future operating results will depend on many factors, including, but not limited to the following:

- demand for our products;
- ability to retain existing customers;
- changes in our pricing policies or those of our competitors;
- new product announcements by us and our competitors;
- the number, timing and significance of product enhancements;
- product life cycles;
- our ability to develop, introduce and market new and enhanced products on a timely basis;
- changes in the level of our operating expenses;
- budgeting cycles of our customers;
- customer order deferrals in anticipation of enhancements or new products that we or our competitors offer;
- changes in our strategy;
- seasonal trends and general domestic and international economic and political conditions, among others; and
- currency exchange rate fluctuations and economic conditions in the geographic areas where we operate.

Our expense levels are substantially based on our expectations for future revenues and are therefore relatively fixed in the short term. If revenue levels fall below expectations, our quarterly results are likely to be disproportionately adversely affected because a proportionately smaller amount of our expenses varies with our revenues. Our operating results are generally not characterized by a seasonal pattern, except that our sales in Europe are generally lower in the summer months.

We typically ship orders for our TABS product shortly after receipt of a purchase order and, consequently, order backlog at the beginning of any quarter has in the past represented only a small portion of that quarter's revenues. As a

result, license revenues from our TABS product in any quarter depend substantially on orders for TABS products that have been booked and shipped in that quarter. Also, we cannot predict whether revenues from our TEM Suite will be recognized in any quarter because the delivery and, in some cases, the implementation of all the components of the TEM Suite (including among, other things, customer training) are dependent on the customers individual timing requirements, which can delay the completion of these orders. In addition, a portion of our revenues from billing solutions are generated by using contract accounting on a percentage of completion method and because the completion pace varies from quarter to quarter and is dependent on different variables that are out of our control, a portion of our billing solutions revenues in any quarter depend on our customers' operational plans, which can delay our ability to progress and complete the projects.

Due to the foregoing, our quarterly financial performance has varied significantly in the past and may vary significantly in the future. Our revenues and operating results in any quarter may not be indicative of our future performance, and it may be difficult for investors to evaluate our prospects. In some future quarter, our operating results may be below the expectations of public market analysts and investors. In such event, it is likely that the price of our ordinary shares would be adversely affected. Accordingly, quarterly revenues and operating results are difficult to forecast, and it is likely that our future operating results will be adversely affected by these or other factors. We believe that period-to-period comparisons of our operating results are not necessarily meaningful and you should not rely upon them as indications of future performance.

Unfavorable national and global economic conditions could adversely affect our business, operating results and financial condition.

Worsening economic conditions, such as the continued European sovereign debt uncertainty, may result in diminished demand for our products and in decreased sales volumes. Although global economic conditions have stabilized or improved since the 2008 financial crisis, many of the markets in which we operate have not fully recovered. If the economies in the countries in which we operate continue to be uncertain or weaken further, the demand for our products and technology may decrease as a result of constraints on capital spending by our customers. In addition, this could result in longer sales cycles and increased price competition for our products. Any of these events would likely harm our business, operating results and financial condition. If global economic and market conditions, or economic conditions in the United States, Europe or Asia or other key markets, remain uncertain or weaken further, our business, operating results and financial condition may be adversely affected.

Because we collect and recognize revenue from services over the term of our customer agreements, the lack of customer renewals or new customer agreements may not be immediately reflected in our operating results.

We collect and recognize revenue from our customers in service agreements over the term of their agreements with us. As a result, the aggregate effect of a decline in new or renewed customer agreements in any one quarter would not be fully recognized in our revenue for that quarter, but would negatively affect our revenue in future quarters. Consequently, the aggregate effect of significant upturns or downturns in sales of our solution would not be fully reflected in our results of operations until future periods.

We face risks associated with expanding and maintaining our distribution network.

We sell our products through distributors, business telephone switching systems manufacturers and vendors, post, telephone and telegraph authorities, or PTTs and our direct sales force. Our ability to achieve revenue growth in the future will depend in large part on our success in establishing and maintaining relationships with business telephone switching systems manufacturers and vendors and PTTs, and establishing and maintaining relationships with distributors. Historically, we have at times experienced difficulty in establishing effective distribution relationships. We may not be able to successfully expand our distribution channels or any such expansion may not result in an increase in revenues. The failure to expand or maintain our distribution channels could adversely affect our business, operating results and financial condition.

We are subject to risks associated with international operations.

We are based in Israel and generate a large percentage of our sales in the United States. Our sales in the United States accounted for 74.2%, 78.1% and 86.4% of our total revenues for the years ended December 31, 2011, 2012 and 2013, respectively. We may not be able to maintain or increase international market demand for our products. To the extent that we cannot do so in a timely manner, our business, operating results and financial condition will be adversely affected.

International operations are subject to inherent risks, including the following:

- the impact of recessionary environments in multiple foreign markets;
- costs of localizing products for foreign markets;

- longer receivables collection periods and greater difficulty in accounts receivable collection;
- unexpected changes in regulatory requirements;
- difficulties and costs of staffing and managing foreign operations;
- reduced protection for intellectual property rights in some countries;
- potentially adverse tax consequences; and
- political and economic instability.

Our distributors or resellers may not be able to sustain or increase revenues from international operations or the foregoing factors may adversely affect our future revenues and, as a result, on our business, operating results and financial condition.

We may be adversely affected by fluctuations in currency exchange rates. While our revenues are generally denominated in U.S. dollars and Euros, a portion of our expenses, primarily salaries, are incurred in NIS. From time to time, we may enter into hedging transactions in order to mitigate such fluctuations. Any hedging transactions that we enter into may not materially reduce the effect of fluctuations in foreign currency exchange rates on our results of operations. In addition, if, for any reason, exchange or price controls or other restrictions on the conversion of foreign currencies into NIS were imposed, our business could be adversely affected. Currency fluctuations in the future may adversely affect our revenues from international sales and, consequently, on our business, operating results and financial condition.

We depend on business telephone system manufacturers, vendors and distributors for our sales.

Historically, one of the primary distribution channels for our call accounting management products has been private branch exchange, or PBX, original equipment manufacturers, or OEMs, and vendors who market our products to end-users in conjunction with their own products. We are dependent upon the active marketing and distribution efforts of our PBX OEMs and local master distributors.

Sales of call accounting solutions by PBX manufacturers and vendors have declined markedly in the recent past, and sales through this channel may continue to decline. Our future success will be dependent to a substantial degree on the marketing and sales efforts of such third parties in marketing and integrating our products. These third parties may not give priority to the sale of our products as an enhancement to their products. Although most of the major business telephone switching systems manufacturers and vendors currently rely on third party suppliers to provide call accounting and other telemanagement products, these manufacturers and vendors, including our current customers, may develop their own competing products or purchase competing products from others.

Because we sell our products through local master distributors in countries where we do not have a marketing subsidiary, we are highly dependent upon the active marketing and distribution efforts of our distributors. We also depend in large part upon our distributors for product maintenance and support. Our distributors may not continue to provide adequate maintenance and support to end-users or provide maintenance and support for new products, which might cause us to seek new or additional distributors or incur additional service and support costs. The distributors to whom we sell our products are generally not contractually required to make future purchases of our products and could, therefore, discontinue carrying our products at any time. None of our distributors or resellers is subject to any minimum purchase requirements under their agreements with us.

We may not be able to continue our relationships with our OEM customers or, if such relationships are not maintained, we may not be able to attract and retain comparable PBX OEMs. The loss of any of our major reseller or OEM relationships, either to competitive products offered by other companies or products developed by such resellers, would adversely affect our business, financial condition and results of operations. Our future performance will depend, in part, on our ability to attract additional PBX manufacturers and vendors that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products.

Breaches of network or information technology security, natural disasters or terrorist attacks could have an adverse effect on our business.

Cyber-attacks or other breaches of network or information technology (IT) security, natural disasters, terrorist acts or acts of war may cause equipment failures or disrupt our systems and operations. In particular, both unsuccessful and successful cyber-attacks on companies have increased in frequency, scope and potential harm in recent years. Such an event may result in our inability to operate our facilities, which, even if the event is for a limited period of time, may result in significant expenses and/or loss of market share to other competitors in the market for telemanagement products and invoice management solutions. While we maintain insurance coverage for some of these events, the potential liabilities associated with these events could exceed the insurance coverage we maintain. A failure to protect the privacy of customer and employee confidential data against breaches of network or IT security could result in damage to our reputation. Any of these occurrences could result in a material adverse effect on our results of operations and financial condition.

We have been subject, and will likely continue to be subject, to attempts to breach the security of our networks and IT infrastructure through cyber-attack, malware, computer viruses and other means of unauthorized access. However, to date, we have not been subject to cyber-attacks or other cyber incidents which, individually or in the aggregate, resulted in a material impact to our operations or financial condition.

We are subject to risks arising from product defects and potential product liability.

We may provide a warranty for up to three months for end-users and, in limited instances, up to 12 months for our OEM distributors. Our sales agreements typically contain provisions designed to limit our exposure to potential product liability or related claims. The limitation of liability provisions contained in our agreements may not be effective. Our products are used by businesses to reduce communication costs, recover charges payable by third parties, prevent abuse and misuse of telephone networks and converged billing solutions for information and telecommunication service providers, and as a result, the sale of products by us may entail the risk of product liability and related claims. A product liability claim brought against us could adversely affect our business, operating results and financial condition. Products such as those offered by us may contain undetected errors or failures when first introduced or when new versions are released. Despite our testing and testing by current and potential customers, errors may be found in new products or releases after commencement of commercial shipments. The occurrence of these errors could result in adverse publicity, loss of or delay in market acceptance or claims by customers against us, any of which could adversely affect our business, operating results and financial condition.

We may not be able to retain or attract the key managerial, technical and research and development personnel we need to succeed.

Our success has largely depended and will depend in the future on our skilled professional and technical employees. The competition for these employees is intense. We may not be able to retain our present employees, or recruit additional qualified employees as we require them. The loss of any key member of our management team might significantly delay or prevent the achievement of our business or development objectives. Our ability to replace key members of our management team and hire additional skilled personnel in the future might be negatively impacted by the use of restrictive covenants in our industry and market. Any failure to attract and retain key managerial, technical and research and development personnel could adversely affect our ability to generate sales, deploy our products or successfully develop new products and enhancements.

We may fail to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, which could have an adverse effect on our financial results and the market price of our ordinary shares.

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and our executives and directors. Our efforts to comply with the requirements of Section 404(a) of the Sarbanes-Oxley Act of 2002 governing internal control and procedures for financial reporting have resulted in increased general and administrative expense and a diversion of management time and attention, and we expect these efforts to require the continued commitment of significant resources. We may identify material weaknesses or significant deficiencies in our assessments of our internal control over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities and could adversely affect our operating results, investor confidence in our reported financial information and the market price of our ordinary shares.

Risk Factors Related to Our Ordinary Shares

A few of our shareholders are in a position to control matters requiring a shareholder vote.

Mr. Chaim Mer, the Chairman of our Board of Directors, and his wife, Mrs. Dora Mer, currently beneficially own approximately 23.8% of our outstanding ordinary shares, the Info Group, Inc. (formerly AnchorPoint, Inc.) whose principal shareholder, Mr. Roger Challen, is one of our directors, currently beneficially owns 21.3% of our outstanding shares and Mr. Isaac Ben-Bassat, one of our directors, beneficially owns 7.4% of our outstanding ordinary shares. As a result, such shareholders control and will continue to control the election of our entire Board of Directors other than our two outside directors and generally have the ability to direct our business and affairs. For as long as such shareholders have a controlling interest in our company, they will have the ability to exercise a controlling influence over our business and affairs, including any determinations with respect to potential mergers or other business combinations involving us, our acquisition or disposition of assets, our incurrence of indebtedness, our issuance of any additional ordinary shares or other equity securities, our repurchase or redemption of ordinary shares and our payment of dividends. This concentration of ownership may also adversely affect our share price, especially if these shareholders sell substantial amounts of our ordinary shares.

If we fail to maintain compliance with NASDAQ's continued listing requirements, our shares may be delisted from the NASDAQ Capital Market.

Our ordinary shares are listed on the NASDAQ Capital Market under the symbol "MTSL." To continue to be listed on the NASDAQ Capital Market, we need to satisfy a number of conditions, including minimum shareholders' equity of at least $2.5 million and a minimum closing bid price per share of $1.00 for 30 consecutive business days. In the past we fell below the minimum $2.5 million shareholders' equity, and we may not be able to maintain such minimum shareholders' equity in the future. If we fail to comply with such requirement, we would have a period of 180 calendar days to achieve compliance by meeting the applicable standard for a minimum of ten consecutive business days. If we are not deemed in compliance before the expiration of the 180 day compliance period, NASDAQ may afford us an additional 180 day compliance period, provided that on the 180th day of the first compliance period we have demonstrated that we meet all applicable standards for initial listing on the NASDAQ Capital Market (except the bid price requirement) based on our most recent public filings and market information. In the past, we received notices from NASDAQ stating that we were not in compliance with NASDAQ Capital Market's continued listing requirements. Although we regained compliance, we cannot be sure that our shareholders' equity, share price or minimum market value of publicly held shares will continue to be in compliance with the requirements for continued listing on the NASDAQ Capital Market, or that any appeal of a decision to delist our ordinary shares will be successful. If we are delisted from NASDAQ, trading in our ordinary shares would be conducted on a market where an investor would likely find it significantly more difficult to dispose of, or to obtain accurate quotations as to the value of, our ordinary shares.

We may be classified as a passive foreign investment company, or PFIC, which will subject our U.S. investors to adverse tax rules.

For U.S. federal income tax purposes, we may be classified as a PFIC for any taxable year in which either: (i) 75% or more of our gross income is passive income or (ii) at least 50% of the average quarterly value of our assets (which may be determined in part by the market value of our ordinary shares, which is subject to change) for the taxable year produce or are held for the production of passive income. As a result of our relatively substantial cash position at this time, we believe that we may be classified as a PFIC in 2013 and future years, including 2014 under a literal application of the asset test described above, which looks solely to the market value of our assets. If we are classified as a PFIC for U.S. federal income tax purposes, highly complex rules would apply to U.S. holders owning our ordinary shares and such U.S. holders could suffer adverse U.S. tax consequences. Accordingly, you are urged to

consult your tax advisors regarding the application of such rules. For more information please see “Item 10. Additional Information – E. Taxation - Certain Material U.S. Federal Income Tax Considerations – Passive Foreign Investment Companies.”

Our share price has been volatile in the past and may decline in the future.

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

- quarterly variations in our operating results;

- operating results that vary from the expectations of securities analysts and investors;
- changes in expectations as to our future financial performance, including financial estimates by investors;
- announcements of technological innovations or new products by us or our competitors;
- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- announcements by third parties of significant claims or proceedings against us;
- changes in the status of our intellectual property rights;
- additions or departures of key personnel;
- future sales of our ordinary shares; and
- general stock market prices and volume fluctuations.

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

In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources.

We do not expect to distribute cash dividends.

We do not anticipate paying cash dividends in the foreseeable future. According to the Israeli Companies Law, a company may distribute dividends out of its profits (within the meaning of the Israeli Companies Law), so long as the company reasonably believes that such dividend distribution will not prevent the company from paying all its current and future debts. The declaration of dividends is subject to the discretion of our Board of Directors and will depend on various factors, including our operating results, financial condition, future prospects and any other factors deemed relevant by our board of directors. You should not rely on an investment in our company if you require dividend income from your investment in our company. The success of your investment will likely depend entirely upon any future appreciation of the market price of our ordinary shares, which is uncertain and unpredictable. There is no guarantee that our ordinary shares will appreciate in value or even maintain the price at which you purchased your ordinary shares.

Risks Relating to Operations in Israel

Political, economic and military instability in Israel may disrupt our operations and negatively affect our business condition, harm our results of operations and adversely affect our share price.

We are incorporated under the laws of, and our principal executive offices, production or manufacturing and research and development facilities are located in, the State of Israel. As a result, political, economic and military conditions affecting Israel directly influence us. Any major hostilities involving Israel, a full or partial mobilization of the

reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel could adversely affect our business, financial condition and results of operations.

Since its establishment in 1948, Israel has been involved in a number of armed conflicts with its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has continued into 2013. In recent years, there was an escalation in violence among Israel, Hamas, the Palestinian Authority and other groups. Also, since 2011, riots and uprisings in several countries in the Middle East and neighboring regions have led to severe political instability in several neighboring states and to a decline in the regional security situation. Such instability may affect the local and global economy, could negatively affect business conditions and, therefore, could adversely affect our operations. In addition, Iran has threatened to attack Israel and is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in areas that neighbor Israel, such as Hamas in Gaza and Hezbollah in Lebanon. To date, these matters have not had any material effect on our business and results of operations; however, the regional security situation and worldwide perceptions of it are outside our control and there can be no assurance that these matters will not negatively affect us in the future. Ongoing violence between Israel and the Palestinians as well as tension between Israel and other countries in the Middle East may materially affect our business, financial condition and results of operations.

Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli companies, and we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

Our results of operations may be negatively affected by the obligation of our personnel to perform military service.

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

Our financial results may be adversely affected by inflation and currency fluctuations.

We report our financial results in dollars, while a portion of our expenses, primarily salaries, are paid in NIS. Therefore, our NIS related costs, as expressed in U.S. dollars, are influenced by the exchange rate between the U.S. dollar and the NIS. The appreciation of the NIS against the U.S. dollar will result in an increase in the U.S. dollar cost of our NIS expenses. We are also influenced by the timing of, and the extent to which, any increase in the rate of inflation in Israel over the rate of inflation in the United States is not offset by the devaluation of the NIS in relation to the dollar. Our dollar costs in Israel will increase if inflation in Israel exceeds the devaluation of the NIS against the dollar or if the timing of such devaluation lags behind inflation in Israel. In the past, the NIS exchange rate with the dollar and other foreign currencies had fluctuated, generally reflecting inflation rate differentials. We cannot predict any future trends in the rate of inflation in Israel or the rate of devaluation or appreciation of the NIS against the dollar. If the dollar cost of our operations in Israel increases, our dollar measured results of operations will be adversely affected. From time to time, we engage in currency-hedging transactions intended to reduce the effect of fluctuations in foreign currency exchange rates on our financial position and results of operations. However, any such hedging transaction may not materially reduce the effect of fluctuations in foreign currency exchange rates on such results.

The government programs and tax benefits we currently participate in or receive require us to meet several conditions. Such programs may be terminated or reduced in the future and restrict our ability to transfer technology outside of Israel.

We have benefited from certain Israeli Government grants, programs and tax benefits. We applied to the Office of the Chief Scientist of the Israeli Ministry of Industry, Trade and Labor for grants for our research and development projects until 2011 and we subsequently received approval for such applications other than our 2011 application. Future grant applications may not be approved by the Office of the Chief Scientist and we may not be able to obtain any such grants in the future. To remain eligible for these grants, programs and tax benefits, we must comply with certain conditions, including making specified investments in fixed assets from our own equity and paying royalties with respect to grants received. In addition, some of these programs restrict our ability to manufacture particular products and to transfer particular technology outside of Israel. If we do not meet these conditions in the future, the benefits we received could be canceled and we may have to refund payments previously received under these programs or pay increased taxes. The Government of Israel has reduced the benefits available under these programs in recent years and these programs and tax benefits may be discontinued or curtailed in the future.

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Service and enforcement of legal process on us and our directors and officers may be difficult to obtain.

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

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

Provisions of Israeli law may delay, prevent or make difficult our acquisition by a third-party, which could prevent a change of control and therefore depress the price of our shares.

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

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 memorandum of association, articles of association and Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, each shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes on, among other things, amendments to a company's articles of association, increases in a company's authorized share capital, mergers and interested party transactions requiring shareholder approval. In addition, a 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 has a duty of fairness toward the company. However, Israeli law does not define the substance of this duty of fairness. Because Israeli corporate law has undergone extensive revision in recent years, there is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

As a foreign private issuer, whose shares are listed on the NASDAQ Capital Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements. We follow Israeli law and practice instead of NASDAQ Stock Market Rules regarding the requirement to maintain a majority of independents directors, the director nomination process and the requirement to obtain shareholder approval for certain dilutive events.

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 Stock Market Rules. We follow Israeli law and practice instead of the NASDAQ Stock Market Rules regarding the requirement to maintain a majority of independents directors, the director nomination process and the requirement to obtain shareholder approval for certain dilutive events (such as for the establishment or amendment of certain equity based

compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company). As a foreign private issuer listed on the NASDAQ Capital Market, we may also follow home country practice with regard to, among other things, compensation of officers 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, or the SEC, 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.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Our company was incorporated under the laws of the State of Israel in December 1995. We are a public limited liability company under the Israeli Companies Law 5739-1999 and operate under such law and associated legislation. Our registered offices and principal place of business are located at 14 Hatidhar Street, Ra anana 4366516, Israel, and our telephone number is +972-9-7777-555. Our website address is www.mtsint.com. The information on our website is not incorporated by reference into this annual report.

We are a worldwide provider of solutions for TEM and billing solutions. Our TEM solutions assist enterprises and organizations in making smarter choices with their telecommunications spending at each stage of the service lifecycle, including allocation of cost, proactive budget control, fraud detection, processing of payments and spending forecasting. Our converged billing solutions have been successfully implemented worldwide by wireless providers, Voice over Internet Protocol, Internet Protocol Television, mobile virtual network operators, or MVNOs, and content service providers. Our converged billing solutions include applications for charging and invoicing customers, interconnect billing and partner revenue management using pre-pay and post-pay schemes.

On December 30, 2008, we completed the acquisition of certain assets and liabilities of AnchorPoint, a Massachusetts-based provider of TEM solutions. This acquisition has enabled us to expand our product offerings. The aggregate consideration paid for the acquisition at the closing date was the issuance of 24.4% of our outstanding shares on a post-transaction basis.

Our capital expenditures for the years ended December 31, 2011, 2012 and 2013 were approximately $2.0 million, $1.5 million and $1.5 million, respectively. These expenditures were principally for research and development equipment, office furniture and equipment and leasehold improvements.

B. Business Overview

Industry Background

We are a global provider of services and solutions in the Telecom Expense Management (TEM), Cloud Billing, Mobile Virtual Network Enabler (MVNE) and Mobile Money markets. Our TEM Suite helps organizations reduce operational expenses, improve productivity and optimize networks and services associated with communications networks and information technology. Our MVNE and Mobile Money offerings enable MVNOs and financial service providers to manage their customers' and resellers' lifecycles. We believe that the MVNE and Mobile Money markets may become the main growth engines for our company.

TEM Industry

The advances in communications technologies and the proliferation of mobile devices have greatly increased the financial and personnel resources required by an enterprise to operate and manage its communications environment. The communications industry has also undergone significant regulatory changes that have resulted in the expansion of the number of service providers and available products. Enterprises need to manage an increasing number of service options and a growing volume and complexity of communications contracts and billing arrangements. Inefficient management of these expenses, including overpayments as a result of billing errors, often results in enterprises incurring significant unnecessary expenses.

Enterprises are increasingly seeking solutions to effectively and efficiently manage, control and optimize their expanding communications assets, services, usage and associated expenses. The TEM market provides solutions to help meet this demand. A number of trends have increased the demand for TEM solutions, such as the growing complexity of communications service plans, large volume and complexity of communications bills and the globalization of business that require corporations to manage their communications assets and services in a centralized fashion across carriers, countries of origin and languages.

Call accounting products, which are fundamental management tools, record, retrieve and process data received from a PBX or other telephone switching system. This information provides a telecommunications manager with information on telephone usage and enables the management of internal billing, fraud detection and optimizes an enterprise's telecommunications resources.

MVNE and Mobile Money Market

We provide services to MVNOs and assist them to reduce their time to market, focus on sales and marketing and reduce their initial capital expenses. An MVNO is a wireless communications services provider that does not own radio spectrum or wireless network infrastructure. An MVNO enters into a business agreement with a mobile network operator with infrastructure to obtain bulk access to network services at wholesale rates, after which the MVNO sets retail plans and prices independently. The emergence of the MVNO model in various markets worldwide is mostly related to changes in regulations and in the ability of MVNOs to address new market segments that may increase their revenue streams.

The mobile money market targets financial service providers and MVNOs in emerging and developing markets that want to provide financial services. Their customers are mainly individuals that have cell phones but no bank accounts. Mobile money solutions provide services such as deposits, withdrawals, person-to-person transfers, bill payments, purchases of goods and more complex banking services over mobile phones.

Cloud Billing Industry

With the increase in bandwidth and the higher availability of cloud computing, enterprises and service providers are looking for cloud billing solutions in order to benefit from the flexibility, resiliency and scalability offered by cloud computing. A positive feature of cloud billing solutions is the change in cost structure from a relatively high upfront capital expense to a cost effective monthly operational expense. Cloud billing solutions are easily adaptable to a company's offerings, pricing model, discounts and promotions.

Products and Services

Call Accounting and Telecommunications Expense Management Solutions for Enterprises

TEM Suite

Our TEM Suite is a solution that assists organizations to reduce their telecom spending, manage their telecom assets, bill internal and external customers, and monitor the quality of service of their telecom networks. Our TEM Suite includes several modules that can be delivered as a SaaS. The TEM Suite software platform encompasses the business processes conducted by IT and finance departments in acquiring, provisioning and supporting corporate telecommunications assets. Solutions include software suites and the outsourcing of specific tasks to third-party service providers. At the heart of any TEM offering is an automated software platform used by the business or by an external service provider managing a company's telecom invoices and assets. In February 2014, our TEM Suite won a 2014 Product of the Year Award from TMC's "Internet Telephony" magazine.

Our TEM Suite enables IT managers and finance teams to monitor, control and save IT and communication expenses by utilizing the following features and functions:

- Invoice Management - Provides enterprises with a simplified and automated tool for monitoring, managing, verifying and routing invoices for payment or correction. Invoice items originate from various sources, which include the telecommunication service provider, the devices used such as calling cards, mobile lines, landlines,

circuits as well as services and equipment provided. Our solution provides an analysis of all invoice data against the agreement between the enterprise and the service provider, real device usage, online inventory, as well as additional equipment or services. This reduces overhead costs caused by invoice and contract discrepancies, disputes and errors.

- Call Accounting- Collection of call data records directly from PBXs, including rates and pricing of calls, and generation of detailed and summary reports.

- Asset Management - Managing and organizing any type of telecom assets (voice, data, and wireless) in the organization, by providing a flexible utility that allows a user to manage new device types. Allocates charges for use of telecom assets and assigns assets to personnel in order to track usage and costs. Generates billing reports.

- Cable Management - Managing and organizing cable connections between devices in the system by connecting segments of devices and cables. Presents a graphical image of the cable map and generates reports.

- Private Calls Management – Management of private calls by personnel allowing the IT manager to obtain a clear picture of the private and business calls made, while maintaining the privacy of the employee, and allocates the costs to the respective business unit and personnel.

- My Portal -A consolidated interface which presents users with required and vital information, such as alerts regarding the behavior of the system, and it performs common tasks in the system, such as defining users and extensions and running reports.

- VOIP Quality of Service –Enables the organization to generate reports concerning the quality of phone calls. This module assists the organization to pinpoint problematic points and bottlenecks in its network and work towards solving them.

- Proactive Alerts – Sophisticated alert mechanism that enables the organization to monitor the system by issuing alerts for exceptional events regarding system health, Quality of Service, misuse of the system by excessive use, budget control and emergency calls, and distributes those alerts to authorized users of the application.

- Tenant Resale – Handles tenant accounts according to different customer billing profiles, supplying them with various kinds of telecom services, including phone usage, instrument/handset installation and maintenance, invoice generation based on usage and tracking of payments.

- Work Order Management - A powerful work flow system for flexible definition of processes, which facilitates the management of work orders and trouble tickets, tracking them from initiation to completion, allowing a close follow up on their assignments and status.

- Procurement Management – A web based employee portal which facilitates the procurement of mobile handsets. The system allows each organization to enforce its procurement policies and approvals.

TEM Services

Map-to-WinSM. Customer engagements begin with Map-to-WinSM, which is a strategic consulting approach for our TEM solution. Map-to-WinSM enables organizations to effectively align their business goals with their people, processes and technology investments to assure that their expense management initiatives will be successful. Our proprietary Map-to-WinSM approach ensures that proven business processes are used to define both the customer's and our responsibilities during setup and implementation. This enables our customers to maximize any process improvement opportunities and ensures that nothing is overlooked during this process.

Consulting Services. Consulting services for our TEM solution are designed to assist companies to develop a strategic telecom plan that is right for their needs and to address their tactical requirements as they arise. Our consulting services work closely with internal IT/telecom and finance teams to ensure a successful TEM solution from start to finish. Our TEM consultants support every stage of the TEM lifecycle, using best-practices-based analysis and processes to help leverage the customers' internal processes and technology. The end result is a long-term, measurable TEM strategy. Our consulting services include:

- invoice and inventory audit and recovery;
- contract negotiations and strategic sourcing;

- discovery and road mapping services;
- process diagnosis and solution design;
- wireless optimization; and
- creation and implementation of IT governance, risk and compliance policies.

MVNE and Cloud Billing Solutions

Our MVNE solution allows MVNOs to reduce their time to market, focus on sales and marketing and reduce their initial capital expenses. Our MVNE solution has the following modules:

- Product Catalog
- Point Of Sale
- Customer Service and Self Care
- Asset management
- Billing (prepaid and postpaid)
- Reseller and distributor management

Mobile Money Solution

Our Mobile Money solution, which can be sold separately or as part of our MVNE solution, allow MVNOs to offer their customers the ability to make deposits, withdrawals, person-to-person transfers, bill payments, purchases of goods and more complex banking services over mobile phones.

Services

Cloud and Managed Services

Our TEM and MVNE solutions are offered either as a perpetual license or as a managed service. Our operation in the U.S. provides cloud based call accounting, TEM managed services and MVNE. We also provide licenses to our local partners to offer the managed service model in their region.

Implementation and Maintenance Service

We provide customer support to end-users and channels (distributors and business partners) in the United States, Israel and Hong Kong on both a service contract and a per-incident basis. Our technical support engineers answer support calls directly and generally seek to provide same-day responses. We provide updated telephone rate tables to customers on a periodic basis under annual service contracts. The rate tables are obtained from third-party vendors who provide this data for all major long-distance service providers. Our distributors provide a full range of service and technical support functions for our products, including rate tables, to their respective end-user customers.

Sales and Marketing

We rely on business partners, our existing customer base and new direct customers for our sales activities. We believe that partnering with business partners is the most advantageous means to generate new sales of our solutions. In addition, our broad base of previously installed solutions, primarily in the United States, provides us with opportunities to offer and sell any new products, solutions and services.

We sell our solutions worldwide through OEMs, distribution channels and our own direct sales force in the United States, Israel and Hong Kong, and through a network of local distributors in these and various other countries. We employed 11 persons in sales and marketing and 20 persons in support as of December 31, 2013, as compared to 13 persons in sales and marketing and 33 persons in support as of December 31, 2012 and ten persons in sales and marketing and 33 persons in support as of December 31, 2011. In 2013, Mer Telecom Ltd., a subsidiary of C. Mer, added the Mobile Money, MVNE and Cloud Billing solutions into its products' offering.

We conduct a wide range of marketing activities aimed at generating awareness and leads. We maintain our websites (www.mtsint.com and www.mtsbill.com), allowing for correspondence and queries from new potential customers as well as promoting support for our existing customer base. The information on our website is not incorporated by reference into this annual report.

Competition

The Global TEM solution and services market is highly competitive and includes recognized leaders such as Tangoe, Inc. and Emptoris Rivermine (IBM's TEM Solution), covered by industry analysts such as Gartner. As an outcome, we focus on our existing installed base and partnerships to grow our business. We invest in the robustness of our products and the professionalism of our managed service team, to increase our value to our customers. There can be no assurance that we will be able to compete successfully against current or future competitors or that competition will not adversely affect our future revenues and, consequently, on our business, operating results and financial condition.

Intellectual Property Rights

We believe that, because of the rapid pace of technological change in the communication industry, the most significant factors in our intellectual property rights are the knowledge, ability and experience of our employees, the frequency of product enhancements and the timeliness and quality of support services provided by us. In addition, we rely upon a combination of security devices, copyrights, trademarks, patents, trade secret laws, confidentiality procedures and contractual restrictions to protect our rights in our products. In 2005, we filed an international patent application (PCT application), which is currently pending, relating to a mobile verification technique that verifies mobile phone usage against the bill received from the service provider. Our policy has been to pursue copyright protection for our software and related documentation and trademark registration of our product names. Some of our products have the added protection afforded by a hardware component which has embedded software that it is difficult to misappropriate. In addition, our key employees and independent contractors are required to sign non-disclosure and confidentiality agreements.

Our trademark rights include rights associated with the use of our trademarks and rights obtained by registration of our trademarks in Israel and the United States. We have also acquired rights in certain registered trademarks and common law trademarks and service marks in past acquisitions. The use and registration rights of our trademarks does not ensure that we have superior rights over other third parties that may have registered or used identical related marks on related goods or services. Trademark rights are territorial in nature; therefore we do not have rights in all jurisdictions.

In December 2011, we settled a patent infringement suit filed by Asentinel LLC, or Asentinel, a competitor of our company, against AnchorPoint, Inc., us and our U.S. subsidiary, MTS IntegraTRAK. We made a lump sum payment for past damages to Asentinel and Asentinel granted us a license to use certain of its patents in return for ongoing annual royalty payments for periods subsequent to January 1, 2012.

C. Organizational Structure

Our wholly-owned subsidiaries in the United States, Hong Kong and the Netherlands, MTS IntegraTRAK Inc., MTS Asia Ltd. and Bohera B.V., respectively, act as marketing and customer service organizations in those countries.

D. Property, Plants and Equipment

Our executive offices and research and development facilities are located at 14 Hatidhar Street, Ra anana, Israel. In February 2013, we renewed the lease for 6,243 square feet under a lease that expires in February 2015, at an annual rental charge of approximately $158,000.

Our U.S. subsidiary, MTS IntegraTRAK, occupies approximately 2,944 square feet of space in River Edge, New Jersey for a monthly rental fee of approximately $4,800 under a lease terminating in February 2019. We have an office in Glendale, California, where we occupy approximately 1,932 square feet of space, under a month-to-month lease for a monthly rental fee of approximately $3,600. In addition, we have an office in Powder Springs, Georgia, where we occupy approximately 4,800 square feet of space under a month-to-month lease for a monthly rental fee of approximately $4,700.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating Results

The following discussion of our results of operations should be read together with our audited consolidated financial statements and the related notes, which appear elsewhere in this annual report. The following discussion contains forward-looking statements that reflect our current plans, estimates and beliefs and involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this annual report.

Background

We were organized under the laws of the State of Israel in December 1995, as a subsidiary of C. Mer Industries Ltd., an Israeli public company (TASE: MER). Since our initial public offering in May 1997, our ordinary shares have been listed on the NASDAQ Stock Market (symbol: MTSL) and are presently listed on the NASDAQ Capital Market.

We have wholly-owned subsidiaries in the United States, Hong Kong and the Netherlands, which act as marketing and customer service organizations in those countries.

Overview

We are a worldwide provider of solutions for TEM and billing solutions. Our TEM solutions assist enterprises and organizations to make smarter choices with their telecommunications spending at each stage of the service lifecycle, including allocation of cost, proactive budget control, fraud detection, processing of payments and spending forecasting. Our converged billing solutions have been successfully implemented worldwide by wireless providers, Voice over Internet Protocol, Internet Protocol Television, MVNO and content service providers. Our converged billing solutions include applications for charging and invoicing customers, interconnect billing and partner revenue management using pre-pay and post-pay schemes.

We operate in two operation-based segments: Enterprise and Service Providers. Our Enterprise segment includes TEM solutions and services and our Service Providers segment includes billing and MVNO services and solutions.

General

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in other currencies are re-measured into dollars in accordance with the principles set forth in Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, Topic 830, “Foreign Currency Translation.” The majority of our sales are made outside Israel in dollars. In addition, substantial portions of our costs are incurred in dollars. Since the dollar is the primary currency of the economic environment in which we and certain of our subsidiaries operate, the dollar is our functional and reporting currency and, accordingly, monetary accounts maintained in currencies other than the dollar are re-measured using the foreign exchange rate at the balance sheet date. Operational accounts and non-monetary balance sheet accounts are measured and recorded at the exchange rate

in effect at the date of the transaction. The financial statements of certain subsidiaries, whose functional currency is not the dollar, have been translated into dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of shareholders' equity in accumulated other comprehensive income (loss).

Key Factors Affecting Our Business

Our operations and the operating metrics discussed below have been, and will likely continue to be, affected by certain key factors as well as certain historical events and actions. The key factors affecting our business and our results of operations include, among others, competition, government regulation, the build out of infrastructures, macro-economic and political risks, churn, seasonality, impact of currency fluctuations and inflation, effective corporate tax rate, conditions in Israel and trade relations. For further discussion of the factors affecting our results of operations, see “Risk Factors.”

MVNO Services

Our improved operations during the last three years have been attributable in great measure to our entry into the MVNO services business. We provide services to MVNOs and assist them to reduce their time to market, focus on sales and marketing and reduce their initial capital expenses. The emergence of the MVNO model in various markets worldwide is mostly related to changes in regulations and in the ability of MVNOs to address new market segments that may increase their revenue streams. Our first MVNO customer was Simple Mobile, a U.S.-based MVNO, for whom we provided MVNE services. In 2011, 2012 and 2013, sales attributable to Simple Mobile accounted for approximately 16.4%, 22.8% and 33.3% of our revenues, respectively. During 2012, Simple Mobile was acquired by TracFone and in 2013 TracFone migrated the hosted billing services to their own platform and did not renew their agreement with us. We are continuing our efforts to gain new customers for our MVNO services, but our future success cannot be assured. If we don’t replace the revenues generated by Simple Mobile LLC, our operating results and financial condition will be adversely affected.

TEM Call Accounting Solutions

The majority of our revenues are derived from our TEM call accounting solutions, whose revenues declined each year from 2006 through 2013 and revenues for these products may not grow in the future. If the market for our TEM solutions fails to grow or stabilize in the future, our business, operating results and financial condition would be adversely affected. Our future financial performance will be dependent to a substantial degree on the successful introduction, marketing and customer acceptance of our TEM call accounting solutions.

Competition

The market for telemanagement products and invoice management solutions is fragmented and is intensely competitive. Competition in the industry is generally based on product performance, depth of product line, technical support and price. We compete both with international and local competitors (including providers of telecommunications services), many of whom have significantly greater financial, technical and marketing resources than us. We anticipate continuing competition in the telemanagement products and invoice management solution market and the entrance of new competitors into the market. Our existing and potential customers, including business telephone switching system manufacturers and vendors, may be able to develop telemanagement products and services that are as effective as, or more effective or easier to use than, those offered by us. Such existing and potential competitors may also enjoy substantial advantages over us in terms of research and development expertise, manufacturing efficiency, name recognition, sales and marketing expertise and distribution channels. We may not be able to compete successfully against current or future competitors and that competition may adversely affect our future revenues and, consequently, on our business, operating results and financial condition.

Proprietary Rights and Risks of Infringement

We believe that, because of the rapid pace of technological change in the communications industry, the most significant factors in our intellectual property rights are the knowledge, ability and experience of our employees, the frequency of product enhancements and the timeliness and quality of support services provided by us. We rely upon a combination of security devices, copyrights, trademarks, patents, trade secret laws, confidentiality procedures and contractual restrictions to protect our rights in our products. We try to protect our software, documentation and other written materials under trade secret and copyright laws, which afford only limited protection. It is possible that others will develop technologies that are similar or superior to our technology. Unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. It is difficult to police the unauthorized use of our products, and we expect software piracy to be a persistent problem, although we are unable to determine the extent to which piracy of our software products exists. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. Our means of protecting our proprietary rights in the United States or abroad may not be adequate or our competition may independently develop similar technology.

It is possible that third parties will claim infringement by us of their intellectual property rights. We believe that software product developers will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Any such claims, with or without merits, could: (i) result in costly litigation; (ii) divert management's attention and resources; (iii) cause product shipment delays; or (iv) require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. If there is a successful claim of product infringement against us and we are not able to license the infringed or similar technology, our business, operating results and financial condition would be adversely affected. We are not aware that we are infringing upon any proprietary rights of third parties.

Results of Operations

The following table presents certain financial data expressed as a percentage of total revenues for the periods indicated:

	Year Ended December 31,		
	2011	2012	2013
Revenues:			
Product sales	31.9 %	27.9 %	16.6 %
Services	68.1	72.1	83.4
Total revenues	100.0 %	100.0 %	100.0 %
Cost of revenues:			
Product sales	9.2	8.8	6.2
Services	23.6	25.4	26.1
Total cost of revenues	32.8	34.2	32.3
Gross profit	67.2	65.8	67.7
Selling and marketing	15.9	18.7	17.4
Research and development, net	15.9	10.1	11.1
General and administrative	32.1	21.4	25.5
Operating income	3.3	15.6	13.7
Financial income, net	-	0.5	0.5
Capital gain on sale of long-term investment	0.7	-	-
Income before taxes on income	4.0	16.0	14.2
Taxes on income, net	(0.1)	5.6	3.5
Net income from continuing operations	3.9	10.4	10.7
Net income (loss) from discontinued operations	(0.7)	-	0.6
Net income	3.2	10.4	11.3

Year Ended December 31, 2013 Compared with Year Ended December 31, 2012

Revenues from Products and Services. Revenues from products and services consist primarily of software license fees sales and revenues from services, including managed services, hosting, consulting, maintenance, training, professional services and support. Revenues from products and services decreased by 4.6% to $12.5 million for the year ended December 31, 2013 from $13.1 million for the year ended December 31, 2012. Revenues from our Enterprise segment decreased by 13.3% to $7.8 million, or 62.4% of our total revenues, for the year ended December 31, 2013 from $9.0 million, or 68.7% of our total revenues, for the year ended December 31, 2012. Revenues from our Service Providers segment increased by 14.6% to $4.7 million, or 37.6 % of our total revenues, for the year ended December 31, 2013 from $4.1 million, or 31.3% of our total revenues, for the year ended December 31, 2012. Revenues from products and services in the U.S. increased by 4.9% to $10.8 million, or 86.4% of our total revenues, for the year

ended December 31, 2013 from $10.3 million, or 78.6% of our total revenues, for the year ended December 31, 2012. We expect that our revenues will decrease in 2014 as a result of the loss of Simple Mobile as a customer.

Cost of Revenues from Products and Services. Cost of revenues from products and services consists primarily of (i) production costs and payments to subcontractors; (ii) certain royalties and licenses payable to third parties (including Asentinel and the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor of the State of Israel, or the OCS), (iii) professional services costs; and (iv) support costs. Cost of revenues from products and services decreased by 11.1% to $4.0 million for the year ended December 31, 2013 from $4.5 million for the year ended December 31, 2012. The decrease in cost of revenues from products and services is primarily attributable to our ceasing to provide services to Simple Mobile during 2013. We expect that our cost of revenues will continue to decline in 2014 due to the projected reduction in revenues.

Selling and Marketing. Selling and marketing expenses consist primarily of costs relating to sales representatives and their travel expenses, trade shows and marketing exhibitions and presales support. Selling and marketing expenses decreased by 12.0% to $2.2 million for the year ended December 31, 2013 from $2.5 million for the year ended December 31, 2012. The decrease in selling and marketing expenses is primarily attributable to a provision we made during 2012 for the repayment of grants received for our foreign marketing expenses in previous years. We expect to report a decrease in our selling and marketing expenses in 2014.

Research and Development, Net. Research and development expenses consist primarily of salaries of employees engaged in on-going research and development activities, outsourcing subcontractor development and other related costs, net of grants that were approved by the OCS. Research and development expenses increased by 7.7% to $1.4 million for the year ended December 31, 2013 from $1.3 million for the year ended December 31, 2012. We expect that our research and development expenses will remain at the same level in 2014 as in 2013.

General and Administrative. General and administrative expenses consist primarily of compensation costs for administration, finance and general management personnel, professional fees and office maintenance and administrative costs. General and administrative expenses increased by 14.3 % to $3.2 million for the year ended December 31, 2013 from $2.8 million for the year ended December 31, 2012. We expect a decrease in our general and administrative expenses in 2014 compared to 2013.

Financial Income, Net. Financial income, net consists primarily of interest income on bank deposits, foreign currency translation adjustments, other interest charges and the financial income (expenses) from option contracts or other foreign hedging arrangements. We recorded $61,000 of financial income, net for the year ended December 31, 2013, compared to $60,000 of financial income, net for the year ended December 31, 2012. Our financial income in both years is primarily attributable to exchange rate and foreign currency translation adjustments.

Taxes on Income. We recorded taxes on income of $435,000 for the year ended December 31, 2013, compared to taxes on income of $736,000 for the year ended December 31, 2012. Our taxes on income for the year ended December 31, 2013 are primarily attributable to net utilization of a deferred tax asset of $371,000 which we recognized in 2012.

Net Income from Discontinued Operations. We recorded a net income from discontinued operations of $73,000 in the year ended December 31, 2013. The income from discontinued operations was attributable to decrease of certain contingent liabilities of our Brazilian subsidiary, TABS Brazil Ltda., whose operations were discontinued in March 2009. We did not record a net income or loss from discontinued operations for the year ended December 31, 2012.

Year Ended December 31, 2012 Compared with Year Ended December 31, 2011

Revenues from Products and Services. Revenues from products and services increased by 9.3% to $13.1 million for the year ended December 31, 2012 from $12.0 million for the year ended December 31, 2011. Revenues from our Enterprise segment decreased by 2.2% to $9.0 million, or 68.7% of our total revenues, for the year ended December

31, 2012 from $9.2 million, or 76.7% of our total revenues, for the year ended December 31, 2011. Revenues from our Service Providers segment increased by 46.4% to $4.1 million, or 31.3% of our total revenues, for the year ended December 31, 2012 from $2.8 million, or 23.3% of our total revenues, for the year ended December 31, 2011. Revenues from products and services in the U.S. increased by 15.7% to $10.3 million, or 78.1% of our total revenues, for the year ended December 31, 2012 from $8.9 million, or 74.2% of our total revenues, for the year ended December 31, 2011. The increase in revenues from products and services in 2012 is primarily attributable to the revenues from our agreement with Simple Mobile.

Cost of Revenues from Products and Services. Cost of revenues from products and services increased by 15.4% to $4.5 million for the year ended December 31, 2012 from $3.9 million for the year ended December 31, 2011. The increase in cost of revenues from products and services is primarily attributable to services associated with the growth of our hosting and managed services business.

Selling and Marketing. Selling and marketing expenses increased by 31.6% to $2.5 million for the year ended December 31, 2012 from $1.9 million for the year ended December 31, 2011. The increase in selling and marketing expenses is primarily attributable to recruitment sales personnel as well as a provision for the repayment of grants received for our foreign marketing expenses in previous years.

Research and Development, Net. Research and development expenses decreased by 31.6% to $1.3 million for the year ended December 31, 2012 from $1.9 million for the year ended December 31, 2011. The decrease in research and development expenses is primarily attributable to a decrease in resources assigned to on-going research and development projects.

General and Administrative. General and administrative expenses decreased by 26.3% to $2.8 million for the year ended December 31, 2012 from $3.8 million for the year ended December 31, 2011. The decrease in general and administrative expenses is primarily attributable to the settlement of the Asentinel litigation in 2011. We expect a slight increase in our general and administrative expenses in 2013 compared to 2012.

Financial Income, Net. We recorded $60,000 of financial income, net for the year ended December 31, 2012, primarily attributable to exchange rate and foreign currency translation adjustments. We recorded $2,000 of financial income, net for the year ended December 31, 2011, primarily attributable to foreign currency translation adjustments.

Taxes on Income. We recorded taxes on income of $736,000 for the year ended December 31, 2012, compared to taxes on income of $10,000 for the year ended December 31, 2011. Our taxes on income for the year ended December 31, 2012 are primarily attributable to a $1,050,000 charge related to the tax assessment from the Israeli tax authorities relating to an Israeli court's decision with respect to our 1997 to 1999 tax years, net of a deferred tax asset recognition of $371,000 based on an estimate of future taxable profits and losses in the tax jurisdictions in which we operate. Our low level of taxes on income for the year ended December 31, 2011 was primarily attributable to the utilization of deferred tax assets by our subsidiary in Hong Kong and lower state income taxes in the U.S.

Net Loss from Discontinued Operations. We recorded a net loss from discontinued operations of $84,000 in the year ended December 31, 2011. The loss from discontinued operations was attributable to certain contingent liabilities of our Brazilian subsidiary, TABS Brazil Ltda., whose operations were discontinued in March 2009. We did not record a net loss from discontinued operations for the year ended December 31, 2012.

Seasonality

Our operating results are generally not characterized by a seasonal pattern except that our volume of sales in Europe is generally lower in the summer months.

Impact of Currency Fluctuation and of Inflation

We report our financial results in dollars and receive payments in dollars for most of our sales, while a portion of our expenses, primarily salaries, are paid in NIS. Therefore, the dollar cost of our operations in Israel is influenced by the extent to which any increase in the rate of inflation in Israel is not offset, or is offset on a lagging basis, by a devaluation of the NIS in relation to the dollar. When the rate of inflation in Israel exceeds the rate of devaluation of the NIS against the dollar, the dollar cost of our operations in Israel increase. If the dollar cost of our operations in

Israel increases, our dollar-measured results of operations will be adversely affected. We cannot assure you that we will not be materially and adversely affected in the future if inflation in Israel exceeds the devaluation of the NIS against the dollar or if the timing of the devaluation lags behind inflation in Israel.

The following table presents information about the rate of inflation in Israel, the rate of devaluation or appreciation of the NIS against the dollar, and the rate of inflation in Israel adjusted for the devaluation:

Year ended December 31,	Israeli inflation rate %	NIS devaluation (appreciation) rate %	Israeli inflation adjusted for devaluation (appreciation) %
2009	3.9	(0.7)	4.6
2010	2.7	(6.0)	8.7
2011	2.2	7.7	(5.5)
2012	1.6	(2.3)	3.9
2013	1.8	(7.0)	8.8

A depreciation of the NIS in relation to the dollar has the effect of reducing the dollar amount of any of our expenses or liabilities which are payable in NIS, unless those expenses or payables are linked to the dollar. This depreciation of the NIS in relation to the dollar has the effect of reducing the dollar amount of any of our expenses or liabilities and also has the effect of decreasing the dollar value of any asset which consists of NIS or receivables payable in NIS, unless the receivables are linked to the dollar. Conversely, any increase in the value of the NIS in relation to the dollar has the effect of increasing the dollar value of any unlinked NIS assets and the dollar amounts of any unlinked NIS liabilities and expenses. During 2009 and 2010 the NIS appreciated against the U.S. dollar, which resulted in an increase in the U.S. dollar cost of our NIS expenses. During 2011 the U.S. dollar appreciated against the NIS, which resulted in a decrease in the U.S. dollar cost of our NIS expenses. During 2012 and 2013, the NIS appreciated against the U.S. dollar.

Because exchange rates between the NIS and the dollar fluctuate continuously, exchange rate fluctuations, particularly larger periodic devaluations, may have an impact on our profitability and period-to-period comparisons of our results. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations.

In 2013, we entered into forward, call and put option contracts in the amount of $2.4 million that converted a portion of our floating currency liabilities to a fixed rate basis, which reduced the impact of the currency changes on our cash flow. The purpose of our foreign currency hedging activities is to protect us from risk that the eventual dollar cash flows from international activities will be adversely affected by changes in the exchange rates. Our put option contracts did not qualify as hedging instruments under ASC 815. Changes in the fair value of put option contracts are reflected in the consolidated statements of operations as financial income or expense. In 2013, we recorded approximately $65,000 as financial income with respect to such transactions in our consolidated statements of operations.

Conditions in Israel

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. See Item 3D “Key Information – Risk Factors – Risks Relating to Operations in Israel” for a description of governmental, economic, fiscal, monetary or political polices or factors that have materially affected or could materially affect our operations.

Trade Relations

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a member of the World Trade Organization and

is a signatory to the General Agreement on Tariffs and Trade, which provides for reciprocal lowering of trade barriers among its members. Israel is also a member of the Organization for Economic Co-operation and Development, or the OECD, an international organization whose members are governments of mostly developed economies. The OECD's main goal is to promote policies that will improve the economic and social well-being of people around the world. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export products covered by such programs either duty-free or at reduced tariffs.

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

Effective Corporate Tax Rate

The Israeli corporate tax rate was 24% in 2011, 25% in 2012 and 25% in 2013. The corporate tax rate increased to 26.5% in 2014. In view of the increase in the corporate tax rate since 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly.

However, certain of our manufacturing facilities have been granted "Approved Enterprise" status under the Law for the Encouragement of Capital Investments, 1959, as amended, commonly referred to as the Investment Law, and, consequently, are eligible, subject to compliance with specified requirements, for tax benefits beginning when such facilities first generate taxable income. Subject to certain restrictions, we are entitled to a tax exemption in respect of income derived from our approved facilities for a period of two years, commencing in the first year in which such income is earned, and will be entitled to a reduced tax rate of 10%-25% for an additional five to eight years if we qualify as a foreign investors' company. If we do not qualify as a foreign investors' company, we will instead be entitled to a reduced rate of 25% for an additional five, rather than eight, years.

In December 2010, the Knesset passed the Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among others, amendments to the Investment Law. According to the amendment, effective January 1, 2011, the benefit tracks in the Investment Law were modified and a flat tax rate applies to our company's entire preferred income. We will be able to opt to apply (the waiver is non-recourse) the amendment and from then on we will be subject to the amended tax rates that are: 2011 and 2012 - 15% (in development area A - 10%), 2013 and 2014 - 12.5% (in development area A - 7%) and in 2015 and thereafter - 12% (in development area A - 6%).

Our taxes outside Israel are dependent on our operations in each jurisdiction as well as relevant laws and treaties. Under Israeli tax law, the results of our foreign consolidated subsidiaries cannot be consolidated for tax

B. Liquidity and Capital Resources

As of December 31, 2013, we had $6.4 million in cash and cash equivalents, $153,000 in marketable securities, $63,000 in restricted cash and working capital of $3.5 million, compared to $4.2 million in cash and cash equivalents, $139,000 in restricted marketable securities and a working capital of $1.6 million as of December 31, 2012. The marketable securities are restricted in order to secure our obligations under one of our lease agreements. The increase in our working capital at December 31, 2013 was primarily attributable to our improved operations.

Cash Flows

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

	Year ended December 31,		
	2011	2012	2013
		(in thousands)	
Net cash provided by operating activities from continuing operations	1,142	807	2,147
Net cash provided by (used in) investing activities	3	(189)	(58)
Net cash provided by financing activities from continuing operations	-	303	90
Net increase in cash and cash equivalents	1,145	921	2,179
Cash and cash equivalents at beginning of period	2,124	3,269	4,190
Cash and cash equivalents at end of period	3,269	4,190	6,369

Net cash provided by operating activities from continuing operations was approximately $2.1 million for the year ended December 31, 2013, compared to net cash provided by operating activities from continuing operations of $807,000 for the year ended December 31, 2012. Net cash used in operating activities from continuing operations was approximately $1.1 million for the year ended December 31, 2011. The increase in cash generated from operating activities from continuing operations in 2013 compared to 2012 is primarily attributable to the payment of approximately $1.2 million in 2012 for a significant portion of the tax liability relating to an Israeli court's decision with respect to our 1997 to 1999 tax years, as well as the decrease in deferred tax assets recorded in 2012.

Net cash used in investing activities was approximately $58,000 for the year ended December 31, 2013 compared to net cash used in investing activities of approximately $189,000 for the year ended December 31, 2012. In 2013 and 2012, net cash used in investing activities was primarily attributable to purchase of property and equipment. Net cash provided by investing activities was approximately $3,000 for the year ended December 31, 2011, primarily attributable to the sale of our ownership interest in Silverbyte Networks Ltd.

Net cash provided by financing activities was approximately $90,000 and approximately $303,000 for the year ended December 31, 2013 and December 31, 2012, respectively. In 2013 and 2012, net cash provided by financing activities was attributable to the proceeds received from employee stock option exercises. We did not use any cash in financing activities for the year ended December 31, 2011.

We currently do not have significant capital spending or purchase commitments, but we expect to engage in capital spending consistent with the level of our operations. We anticipate that our cash on hand and cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for at least 12 months.

Discussion of Critical Accounting Policies and Estimations

The preparation of financial statements in conformity with generally accepted accounting principles requires us 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. Actual results could differ from those estimates and the use of different assumptions would likely result in materially different results of operations.

Critical accounting policies are those that are both most important to the portrayal of a company's financial position and results of operations, and require management's most difficult, subjective or complex judgments. Although not all of our significant accounting policies require management to make difficult, subjective or complex judgments or estimates, the following policies and estimates are those that we deem most critical:

Revenue Recognition. We account for our revenue in accordance with the provisions ASC 985-605, "Revenue recognition – Software," as amended, or ASC 985-605. When an arrangement does not require significant production, modification or customization of software or does not contain services considered to be essential to the functionality of the software, revenue is recognized when the following four criteria are met:

- Persuasive evidence of an arrangement exists. We require evidence of an agreement with a customer specifying the terms and conditions of the products or services to be delivered typically in the form of a purchase order or the customer's signature on our proposal;

- Delivery has occurred. For software licenses, delivery takes place when the software is installed on site or remotely or is shipped via mail on a compact disc or server. For services, delivery takes place as the services are provided;

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The fee is fixed or determinable. Fees are fixed or determinable if they are not subject to a refund or cancellation and do not have payment terms that exceed our customary payment terms; and

- Collection is probable. We perform a credit review of all customers with significant transactions to determine whether a customer is credit worthy and collection is probable.

In general, revenue for transactions that do not involve software customization or services considered essential to the functionality of the software is recognized as follows: (i) software license fees for sales through OEMs are recognized upon receipt of license activity reports; (ii) all other software license fees are recognized upon delivery of the software; (iii) software maintenance and technical support are recognized ratably over the contract term; and (iv) consulting, training and other similar services are recognized as the services are performed.

We exercise judgment and use estimates in connection with the determination of the amount of product software license and services revenues to be recognized in each accounting period. If the fee due from the customer is not fixed or determinable, revenue is recognized as payments become due from the customer. If collection is not considered probable, revenue is recognized when the fee is collected.

A limited number of our software arrangements involve multiple elements. Such elements typically include any or all of the following: software licenses, warranty, technical support and training services. For multiple-element arrangements that do not involve significant modification or customization of the software and do not involve services that are considered essential to the functionality of the software, we attempt to allocate value to each undelivered element based on vendor specific objective evidence, or VSOE, of the fair value of each undelivered element in the arrangement, in accordance with the residual method. However, since we have an immaterial number of multiple element arrangements, therefore no VSOE is established.

Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered element and is recognized as revenue when all revenue recognition criteria of ASC 985-605 are satisfied. Under the residual method, any discount in the arrangement is allocated to the delivered element. However, if sufficient specific objective evidence does not exist for all undelivered elements, revenue is deferred for the entire arrangement until all revenue recognition criteria are met for such undelivered elements.

Revenues from maintenance and support services are recognized over the term of the maintenance and support agreement on a straight line basis. Deferred revenues include unearned amounts received under maintenance and support contracts, not yet recognized as revenues.

Revenues for hosting and managed services are recognized based on Staff Accounting Bulletin No. 104 and ASC 605-25, when delivery has occurred or services have been rendered, the fee is fixed and determinable, collectability is probable and persuasive evidence of an arrangement exists. These revenues are recognized as one unit of accounting, on a straight line basis over the term of the last undelivered element.

Allowances for Doubtful Accounts. We perform ongoing credit evaluations of our customers' financial condition and we require collateral as deemed necessary. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments. In judging the adequacy of the allowance for doubtful accounts, we consider multiple factors including the aging of our receivables, historical bad debt experience and the general economic environment. Management applies considerable judgment in assessing the realization of receivables, including assessing the probability of collection and the current credit worthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Income Taxes. Estimates and judgments are required in the calculation of certain tax liabilities and in the determination of the recoverability of certain of the deferred tax assets, which arise from net operating losses tax carryforwards and temporary differences between the tax and financial statement recognition of revenue and expense. FASB ASC Topic 740, "Income Taxes" also requires that the deferred tax assets be reduced by a valuation allowance, if based on the weight of available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods.

In evaluating our ability to recover our deferred tax assets, in full or in part, we consider all available positive and negative evidence including our past operating results, the existence of cumulative losses in the most recent fiscal years and our forecast of future taxable income on a jurisdiction by jurisdiction basis. In determining future taxable income, we are responsible for assumptions utilized, including the amount of Israeli and international pre-tax

operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we use to manage the underlying businesses.

Based on estimates of future taxable profits and losses in the tax jurisdictions that we operate, we determined that a valuation allowance of $5.65 million is required for tax loss carryforwards and other temporary differences as of December 31, 2013. If these estimates prove inaccurate, a change in the valuation allowance could be required in the future.

Contingencies. We are involved in legal proceedings and other claims from time to time. We are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for any contingencies are made after careful analysis of each individual claim. The required reserves may change due to future developments in each matter or changes in approach, such as a change in the settlement strategy in dealing with any contingencies, which may result in higher net loss. If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material. See “Item 8A. Financial Information – Consolidated Statements and Other Financial Information – Legal Proceedings.”

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," Intangibles—Goodwill and Other," goodwill is subject to an annual impairment test, or more frequently if impairment indicators are present. Goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. We operate in two reporting units: Enterprise and Service providers. All goodwill balances are assigned to our Enterprise reporting unit.

Under ASU 2011-08, "Intangibles Goodwill and Other" (Topic 350), or ASU 2011-08, which amended the rules for testing goodwill for impairment, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary.

We adopted the provisions of ASU 2011-08 for our annual impairment tests in 2012. For 2013 we engaged with a third party to perform an annual impairment tests and did not identify any impairment losses. We performed our annual impairment assessment as of September 30, 2013. In addition, for the period from September 30, 2013 until December 31, 2013, no events occurred or circumstances changed that reduced the fair value of the reporting unit below its carrying value.

Other intangible assets and long-lived assets. Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up in accordance with ASC 350. Our long-lived assets and certain identifiable intangibles 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 to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2012 and 2013, no impairment losses were identified.

Developed technology is amortized over a period of four-to-eight years, customer relationships are amortized over a period of six to eight years and brand names are amortized over a period of eleven years. During 2011, 2012 and 2013, no impairment losses were identified.

Stock based compensation. We apply ASC 718 "Compensation - Stock compensation," and ASC 505-50 "Equity-Based Payments to Non-Employees," or ASC 718, with respect to options and warrants issued to non-employees. ASC 718 requires the use of an option valuation model to measure the fair value of the options and warrants at the measurement date as defined in ASC 505-50. ASC 718 requires companies to estimate the fair value of stock-based awards on the date of grant using an option-pricing model, where applicable. Stock-based compensation expense recognized in our consolidated statements of operations for the three years ended December 31, 2013 include compensation expense for stock-based awards granted based on the grant date fair value estimated in

accordance with the provisions of ASC 718.

We recognize these compensation costs net of a forfeiture rate and recognize the compensation costs for only those shares expected to vest on a straight-line basis over the requisite service period for each separately vesting portion of the award, which is the option vesting term of four years. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We estimate the fair value of stock options granted using the Black-Scholes-Merton option pricing model. Stock-based compensation expense recognized under ASC 718 and ASC 505-50 were approximately $67,000, $44,000 and $107,000 for the years ended December 31, 2011, 2012 and 2013, respectively.

Recently Issued Accounting Standards

In February 2013, the FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income." Under ASU 2013-02, an entity is required to provide information about the amounts reclassified out of Accumulated Other Comprehensive Income, or AOCI, by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU 2013-02 does not change the requirements for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 is effective as of January 1, 2013. Since this standard only impacts presentation and disclosure requirements, its adoption did not have a material impact on our consolidated results of operations or financial condition.

In July 2013, the Financial Accounting Standards Board ("FASB") issued a new accounting standard that will require the presentation of certain unrecognized tax benefits as reductions to deferred tax assets rather than as liabilities in the consolidated balance sheets when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The Company will be required to adopt this new standard on a prospective basis in the first quarter of fiscal 2015; however, early adoption is permitted as is a retrospective application. The Company is currently evaluating the impact of this new standard on its consolidated financial statements.

C. Research and Development

Our product development plans are market-driven and address the major, fast-moving trends that are influencing the telecommunications industry. We intend to expand upon our existing family of TEM solutions by adding new features and functions to address evolving market needs.

Our research and development staff is evaluating approaches to solutions which will permit an information technology manager to effectively measure the quality of the services received from their service providers and to ensure that the users within the organization received such services according to their needs and the overall policy and priorities of the organization.

We work closely with our customers and prospective customers to determine their requirements and design enhancements and new releases to meet their needs. Research and development activities take place in our facilities in Israel. We employed 12 persons in research and development as of December 31, 2013, as compared to 12 persons in research and development as of December 31, 2012 and 15 persons in research and development as of December 31, 2011.

We have committed substantial financial resources to research and development for our TEM and billing solution activities. Among our various development plans, our roadmap includes the integration of our TEM products with our other complementary TEM products within the next few years. During 2011, 2012 and 2013, our net research and development expenditures were $1.9 million, $1.3 million and $1.4 million, respectively. In the past, we received funding from the OCS for selected research and development projects. We applied to the OCS for new grants for our research and development projects until 2011 and we have subsequently received approval for such applications other than the 2011 application.

Under the terms of research and development grants that we have received from the OCS, we are required to pay royalties on the revenues derived from products incorporating know-how developed with such grants and ancillary services in connection therewith, up to 100% to 150% of the dollar-linked value of the total grants, plus interest. We

are required to pay royalties at a rate of 3%-5%. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, no payment is required. Since June 1997, we have paid the OCS royalties on all call accounting product sales at the applicable rates at the time of payment. See Item 10E. "Additional Information - Taxation - Grants under the Law for the Encouragement of Industrial Research and Development, 1984." As of December 31, 2013, we had a contingent obligation to pay royalties to the OCS in the amount of approximately $8.6 million plus interest at a rate equal to the 12 month LIBOR rate for grants received after January 1999.

Our quality management system has been ISO 9001:2000 certified since the beginning of 2006, and prior thereto was ISO 9001:1994 certified.

D. Trend Information

As a result of a less predictable business environment and the decline in worldwide sales of PBX systems, we are unable to provide any guidance as to current sales and profitability trends. We expect that our results will continue to be impacted by a shift to a new line of products and increased cost of services and selling and marketing expenditures.

E. Off-Balance Sheet Arrangements

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

F. Tabular Disclosure of Contractual Obligations

The following table summarizes our minimum contractual obligations and commercial commitments as of December 31, 2013 and the effect we expect them to have on our liquidity and cash flow in future periods.

Contractual Obligations	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
	(U.S. dollars in thousands)				
Operating lease obligations	479	217	136	116	10
Accrued severance pay*	857	--	--	--	857
Total	1,336	217	136	116	867

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* See Item 6D. “Directors, Senior Management and Employees - Employees.”

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

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

Name	Age	Position with the Company
Chaim Mer	66	Chairman of the Board of Directors
Eytan Bar	48	Chief Executive Officer
Alon Mualem	47	Chief Financial Officer
Josef Brikman	56	President, North America Operations
Isaac Ben-Bassat	60	Director
Eytan Barak (1) (2)	69	Outside Director
Roger Challen	68	Director

Steven J. Glusband	67	Director
Yaacov Goldman (1) (2)	59	Director
Varda Trivaks (1) (2)	57	Outside Director

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(1) Member of our audit committee
(2) Member of our compensation committee

Messrs. Mer, Ben-Bassat, Challen, Glusband and Goldman will serve as directors until our 2014 Annual General Meeting of Shareholders. All of such persons were elected to serve as directors by our shareholders at our 2013 Annual General Meeting of Shareholders. Ms. Trivaks will serve as an outside director pursuant to the provisions of the Israeli Companies Law for a second three-year term until August 2014, following which her service may be renewed for a third three-year term. Mr. Barak will serve as an outside director pursuant to the provisions of the Israeli Companies Law for a third three-year term until December 2016. Mr. Lior Salansky, who was a member of our board of directors since April 2008, resigned as a director effective January 31, 2014.

Chaim Mer has served as the Chairman of our Board of Directors and a director since our inception in December 1995. Mr. Mer has served as the Chairman of the Board of Directors of C. Mer Industries Ltd., a publicly traded company, since 1988 and served as its President and Chief Executive Officer from 1988 until January 2005. Mr. Mer holds a B.Sc. degree in Computer Sciences and Mathematics from the Technion - Israel Institute of Technology.

Eytan Bar has served as our Chief Executive Officer since December 2003 and served as our President from December 2003 to February 2008. Prior to joining our company and from 2001, Mr. Bar served as General Manager of the customer experience management division of NICE Systems Ltd. From 2000 through 2001, Mr. Bar served as Vice President of Professional Services at NICE Systems Inc. From 1993 through 1999, Mr. Bar served as General Manager of STS Software Systems Ltd., a company that developed a unique VoIP technology for recording solutions.

Alon Mualem has served as our Chief Financial Officer since September 2007. Prior to joining our company and from June 2005, Mr. Mualem held the responsibilities of chief financial officer at Xfone, Inc. (AMEX and TASE: XFN), an international communications services company and its subsidiary, Xfone 018 Ltd. Prior to that, Mr. Mualem served as chief financial officer of CheckM8, Ltd., a high-tech Internet advertising firm located in Israel. From 1998 to 2004, Mr. Mualem served as the corporate controller of RADVISION Ltd. (NASDAQ: RVSN) and from 1996 to 1998, Mr. Mualem served as a deputy controller of RAD Data Communication Ltd. From 1992 to 1996, Mr. Mualem served as a certified public accountant at Somekh Chaikin, a member firm of KPMG International. Mr. Mualem holds a B.A. degree in Economics and Accounting from Tel Aviv University and is Certified Public Accountant (Israel).

Josef Brikman has served as our President of North America operations since May 2011. Mr. Brikman also serves as President of MER Security Inc., which he joined in 2008. From 2006 to 2008, Mr. Brikman was a co-founder of a financial consulting company. Mr. Brikman had previously served our company as Chief Financial Officer from 1998 to 2004. Previously, Mr. Brikman was co-founder and co-manager of STS Software Systems Ltd. Mr. Brikman holds a B.Sc. degree from Fairleigh Dickenson University and a B.A. degree from Haifa University.

Isaac Ben-Bassat has served as a director since our inception in December 1995. Mr. Ben-Bassat has been Executive Vice President and a director of C. Mer since 1988. Mr. Ben-Bassat holds a B.Sc. degree in Civil Engineering from the Technion - Israel Institute of Technology.

Eytan Barak has served as an outside director of our company from August 2007 and is a member of our audit committee. Mr. Barak is joint owner and chief executive officer of Dovrat - Barak, Investments in Advanced Technologies Ltd., which provides financial resources and management assistance to start-up companies. Mr. Barak also serves as a member of the board of directors, audit committee and investment committee of various Israeli companies, including Eltek Ltd., Meshulam Levinstein Construction and Engineering Ltd., Spectronix Ltd. and Menorah-Mivtachim Mutual Funds Ltd. From 1973 to 1997, Mr. Barak was with Israel Corporation, initially serving as its corporate controller and thereafter as its chief financial officer, and also served as chairman or member of the board of directors of some of its subsidiaries. From 1967 until 1973, Mr. Barak was associated with Kesselman & Kesselman, the Israeli member firm of PricewaterhouseCoopers International Limited. Mr. Barak holds a B.A. degree in accounting from Tel Aviv University and has been a certified public accountant (Israel) since 1971.

Roger Challen has served as a director since April 1, 2009. Mr. Challen co-founded The Info Group, Inc. (formerly AnchorPoint, Inc.), a company that developed and provided licensed software and managed services of telecommunications expense management solutions. Mr. Challen is an accomplished entrepreneur with a proven track record of founding, managing and developing companies in the software, telecommunications and information services fields. Mr. Challen has founded or co-founded and been an active executive of several privately held companies in the software and IT services market. Mr. Challen is currently a director of The Info Group, Inc., Image Data, Inc and Data Distributors, Inc., all of which are private companies. Mr. Challen began his career with IBM Corporation, in Waltham, Massachusetts, where he served as a systems engineer and then as a marketing representative. During his tenure with IBM, Mr. Challen won several awards for outstanding technical and sales achievements. Mr. Challen holds a B.A. in Economics and Mathematics from Yale University.

Steven J. Glusband has served as a director since August 1, 1996. Mr. Glusband has been a partner with Carter Ledyard & Milburn LLP, our U.S. counsel, since March 1987. Mr. Glusband holds a B.B.A. degree from the City College of the City University of New York, a J.D. degree from Fordham University School of Law and an L.L.M. degree from the New York University School of Law.

Yaacov Goldman has served as a director since May 2004 and is a member of our audit committee. Mr. Goldman provides consulting services to companies in strategic-financial areas, through his wholly owned company, Maanit-Goldman Management & Investments (2002) Ltd. Mr. Goldman also serves as a director of Golden House Ltd., Collect Biomed Ltd., Isrotel Ltd., Meitav Dash Investments Ltd., Medi Power (Overseas) Public Co. Limited, IceCure Medical Ltd. Proteologics Ltd. and Renewable Resources Ltd. and its affiliated companies. Until March 2012, Mr. Goldman served as a director of Elron Electronic Industries Ltd. and Negev Ceramics Ltd. Until July 2010, Mr. Goldman served as a director of Bank Leumi Le'Israel Ltd. and until June 2009 as Chairman of ITGI Medical Ltd. Mr. Goldman served as the Professional Secretary of the Peer Review Institute of the Certified Public Accountants Institute in Israel from October 2004 until September 2008. Commencing in 1981, Mr. Goldman worked for Kesselman & Kesselman (Israeli member firm of PricewaterhouseCoopers) for 19 years, and from 1991 until 2000, as a partner and then senior partner of such firm. From September 2000 until November 2001, Mr. Goldman served as managing director of Argoquest Holdings, LLC. From March 2002 until October 2002, Mr. Goldman acted as a consultant to a private equity initiative with Poalim Capital Markets & Investments Ltd. Mr. Goldman holds a B.A. degree in Economics and Accounting from Tel Aviv University and is a Certified Public Accountant (Israel).

Varda Trivaks has served as an outside director since August 2008 and is a member of our audit committee. Ms. Trivaks serves as the Managing Director and is one of the two founding partners of Mimtar Business Consulting, established in 2001. In that position, Ms. Trivaks acts as an advisor to companies on investments, mergers, spin-offs, valuation, control, budgeting, with a special focus on advising global companies and management of companies during times of restructuring and recovery. Ms. Trivaks serves as a member of the audit committee, board of directors and/or financial committee of Ginegar Plastic Products Ltd. and E. Schnapp & Co. Works Ltd. From 1998 to 2004, Ms. Trivaks was a member of the Israel Accounting Institute’s communications committee for Capital Markets and Insurance. From 1998 to 2001, Ms. Trivaks was a partner with the accounting and consulting firm, Shlomo Ziv and Co. - BDO, and served as the managing director of one of its subsidiaries. Ms. Trivaks is a Certified Public Accountant (Israel) since 1987 and holds a B.A. degree in Economics and Accounting from Tel Aviv University and a Master of Science in Management from Boston University.

B. Compensation

The following table sets forth all compensation we paid with respect to all of our directors and executive officers as a group for the year ended December 31, 2013.

	Salaries, fees, commissions and bonuses	Pension, retirement and similar benefits
	(in thousands)	
All directors and executive officers as a group (11 persons)	$ 1,231 (1)	$ 80

(1) In addition to this amount, we provide automobiles to certain of our executive officers at our expense.

Mr. Chaim Mer, the Chairman of our Board of Directors, devotes approximately 20% of his time to the management of our company in consideration of which we pay him a monthly salary of $7,000.

With respect to Messrs. Ben-Bassat, Challen, and Glusband, in 2013 we paid them an annual fee of approximately $8,400 and a per meeting attendance fee of $300.

With respect to Mr. Goldman (effective May 2013 until which point he received an annual fee of $16,800 and a per meeting fee of $400), Mr. Salansky (effective December 2012) and our outside directors, we pay an annual fee, payable quarterly, of NIS 30,500 (currently equivalent to approximately $8,700) and a per meeting attendance fee of NIS 1,700 (currently equivalent to approximately $480).

At our 2013 Annual General Meeting of Shareholders, our shareholders approved a bonus plan for our chief executive officer for the 2013-2014 period. In addition, our board of directors and compensation committee approved a bonus plan for two other executives for the same period.

At the 2013 Meeting, our shareholders approved the grant of options to our CEO to purchase 80,000 ordinary shares. The options were granted under our 2003 Plan and will vest in four equal annual installments, commencing on May 8, 2014 and ending on May 8, 2017. The options will expire on the fifth anniversary of the date of the 2013 Meeting (August 7, 2013) unless earlier terminated pursuant to the terms of the 2003 Plan. The exercise price per share of the options is equal to the closing price per share of our ordinary shares on the NASDAQ Capital Market on the date of the 2013 Meeting ($2.08).

As of December 31, 2013, our three executive officers held options to purchase an aggregate amount of 346,250 ordinary shares with exercise prices ranging from $1.44 to $2.26 and a vesting period of four years commencing on the respective grant dates of the options. Of such options, options to purchase 26,250 ordinary shares will expire in May 2014, options to purchase 112,500 ordinary shares will expire in August 2016, options to purchase 87,500 ordinary shares will expire in November 2016, options to purchase 40,000 ordinary shares will expire in May 2018 and options to purchase 80,000 ordinary shares will expire in August 2018. Such options were granted under our 2003 Israeli Share Option Plan and 2006 Stock Option Plan. In 2013, 35,250 options were exercised.

At the 2013 Meeting, our shareholders also approved the grant of options to Mr. Lior Salansky to purchase 40,000 ordinary shares. On January 29, 2014, the Company received notice from Mr. Lior Salansky that he was resigning as a director of the Company effective January 31, 2014 and all of the options granted to Mr. Salansky subsequently expired.

See Item 6E., “Directors, Senior Management and Employees - Share Ownership – Stock Option Plans.”

C. Board Practices

Election of Directors

Our Articles of Association provide for a Board of Directors consisting of up to twelve members or such other number as may be determined from time to time at a general meeting of shareholders. Our Board of Directors is currently composed of eight directors.

Pursuant to our articles of association, all of our directors (except the outside directors) are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual general meeting of shareholders and until their successors have been elected. The Board of Directors, may, at any time from time to time, appoint any other person as a director, whether to fill a casual vacancy or to add to their number. All the members of our Board of Directors (except the outside directors) may be reelected upon completion of their term of office. All of our current directors (including one outside director) were elected by our shareholders at our annual general meeting of shareholders held in August 2013.

We do not follow the requirements of the NASDAQ Stock Market Rules with regard to the nomination process of directors, and instead, we follow Israeli law and practice, in accordance with which our directors are recommended by our board of directors for election by our shareholders. See below in this Item 16G. “Corporate Governance.”

Outside and Independent Directors

Outside Directors. Under the Israeli Companies Law, companies incorporated under the laws of the State of Israel whose shares have been offered to the public are required to appoint at least two outside directors. The Israeli Companies Law provides that a person may not be appointed as an outside director if the person is a relative of the controlling shareholder of the company, or if the person, the person's relative, partner, employer or an entity under that person's control, has or had during the two years preceding the date of appointment any affiliation with the company, the controlling shareholder of the company or its relative, or any entity controlling, controlled by or under common control with the company. The term "relative" means a spouse, sibling, parent, grandparent, child or child, sibling or parent of a spouse or spouse of any of the foregoing. The term affiliation includes:

- an employment relationship;

- a business or professional relationship maintained on a regular basis;
- control; and
- service as an officer holder, excluding service as an outside director of a company that is offering its shares to the public for the first time.

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

At least one of the outside directors elected must have "accounting and financial expertise" and any other outside director must have "accounting and financial expertise" or "professional qualification," as such terms are defined by regulations promulgated under the Israeli Companies Law.

Outside directors are elected by shareholders. In general, outside directors serve for a three-year term, which may be renewed for only two additional three-year term. The election of an outside director for the initial three-year term requires the affirmative vote of a majority of the shares present, in person or by proxy, and voting on the matter, provided that either: (i) at least a majority of the shares of non-controlling shareholders and shareholders who do not have a personal interest in the resolution (excluding a personal interest that is not related to a relationship with the controlling shareholders) are voted in favor of the election of the outside director, or (ii) the total number of shares of non-controlling shareholders and of shareholders who do not have a personal interest in the resolution (excluding a personal interest that is not related to a relationship with the controlling shareholders) voted against the election of the outside director does not exceed two percent of the outstanding voting power in the company.

An outside director may be re-elected to serve for two additional three-year terms in one of the two following methods: (i) the board of directors proposed the nomination of the outside director for an additional term and her or his appointment is approved by the shareholders in the manner required to appoint outside directors for an initial term as set forth above, or (ii) in the event a shareholder holding 1% or more of the voting rights nominates the outside director for an additional term, the nomination is required to be approved by a majority of the votes cast by the shareholders of the company; provided that: (x) the votes of controlling shareholders, the votes of shareholders who have a personal interest in the approval of the appointment of the outside director, other than a personal interest that is not as a result of such shareholder's connections to the controlling shareholder, and abstaining votes are excluded from the counting of votes and (y) the aggregate votes cast by shareholders in favor of the nomination that are counted for purposes of calculating the majority exceeds 2% of the voting rights in the company. The outside director nominated by shareholders may not be a related or competing shareholder or a relative of such shareholder at the date of appointment and may not have an affiliation to a related or competing shareholder at the date of appointment or for the two year period prior to the appointment. A "related or competing shareholder" is defined by the Companies Law as the shareholder that proposed the nomination or a significant shareholder (a shareholder holding five percent or more of the outstanding shares of a company or of the voting rights in a company), provided that at the date of appointment of the outside director such shareholder, its controlling shareholder or a corporation controlled by either of them, have business connections with the company or are competitors of the company. The term "affiliation" is defined as set forth above.

Outside directors can be removed from office only by the same special percentage of shareholders as can elect them, or by a court, and then only if the outside directors cease to meet the statutory qualifications with respect to their

appointment or if they violate their duty of loyalty to the company.

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

Independent Directors. In general, NASDAQ Stock Market Rules require that the board of directors of a NASDAQ-listed company have a majority of independent directors, within the meaning of the NASDAQ Stock Market Rules, and our audit committee must have at least three members and be comprised only of independent directors, each of whom satisfies the respective "independence" requirements of the SEC and NASDAQ. However, foreign private issuers, such as our company, may follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Stock Market Rules. A foreign private issuer that elects to follow a home country practice instead of such 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. On March, 31, 2009, we provided NASDAQ with a notice of non-compliance with respect to the requirement to maintain a majority of independent directors, within the meaning of the NASDAQ Stock Market Rules. Instead, under Israeli law and practice, we are required to appoint at least two outside directors, within the meaning of the Israeli Companies Law, to our Board of Directors. In addition, in accordance with the rules of the SEC and NASDAQ, our audit committee is composed of three independent directors, as defined by the rules of the SEC and NASDAQ.

Pursuant to the Israeli Companies Law, a director may be qualified as an independent director if such director is either (i) an outside director; or (ii) a director that serves as a board member less than nine years (subject to the right to extend such period for additional three-year terms granted to certain companies, including companies whose shares are listed on Nasdaq) and the audit committee has approved that he or she meets the independence requirements of an outside director. A majority of the members serving on the audit committee must be independent under the Israeli Companies Law. In addition, a publicly traded company may elect to adopt a provision in its articles of association pursuant to which a majority of its board of directors will be independent. We have not included such a provision in our articles of association.

Our Board of Directors has determined that our outside directors, Mr. Eytan Barak and Ms. Varda Trivaks, both qualify as independent directors under the rules of the SEC and NASDAQ. Our Board of Directors has further determined that each of Messrs. Steven Glusband and Yaacov Goldman qualifies as an independent director under the requirements of the SEC, NASDAQ and the Israeli Companies Law.

Audit Committee

Our audit committee, which was established in accordance with Section 114 of the Israeli Companies Law and Section 3(a)(58)(A) of the Exchange Act, assists our board of directors in overseeing the accounting and financial reporting processes of our company and audits of our financial statements, including the integrity of our financial statements, compliance with legal and regulatory requirements, our independent public accountants' qualifications and independence, the performance of our internal audit function and independent public accountants, finding any defects in the business management of our company and proposing to the board of directors ways to correct such defects, and such other duties as may be directed by our board of directors. The responsibilities of the audit committee also include determination as to whether or not a transaction is an "extraordinary transaction" or an action is a "material action" and, to the extent required, approving such related-party transactions and actions as required by law. In a recent amendment to the Companies Law, which became effective in January 2014, two additional functions were added to audit committees: (a) to determine in connection with transactions with the controlling shareholder or with a third party in which the controlling shareholder has a personal interest (all whether such transactions are extraordinary or not) and in connection with transactions with the controlling shareholder or its relative, directly or indirectly, for the receipt of services or in connection with terms of employment or service, a duty to conduct a competitive process, supervised by the audit committee or anyone else appointed by the audit committee and based on criteria determined by the audit committee, or to determine that other procedures determined by the audit committee will be conducted, prior to execution of such transactions, all based on the type of the transaction (the audit committee is permitted to determine criteria for this matter once a year in advance) and (b) to determine the method of approval of non-negligent

transactions (i.e., transactions of a company with a controlling shareholder or with a third party in which the controlling shareholder has a personal interest that the audit committee determined are not extraordinary but are non-negligent), including to determine types of such transactions that will require the approval of the audit committee (the audit committee is permitted to determine a classification of transactions as non-negligent based on criteria determined once a year in advance). Under Israeli law an audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder, unless at the time of approval two outside directors are serving as members of the audit committee and it otherwise meets the composition requirements of the Israeli law.

Our audit committee consists of three members of our Board of Directors who satisfy the "independence" requirements of the SEC, NASDAQ and Israeli law for audit committee members. Our audit committee is currently composed of Messrs. Eytan Barak and Yaacov Goldman and Ms. Varda Trivaks. Our Board of Directors has determined that Mr. Goldman qualifies as an audit committee financial expert. The audit committee meets at least once each quarter.

Compensation Committee

In accordance with the Israeli Companies Law, our compensation committee's role is to: (i) recommend a compensation policy for office holders and to recommend to the board, once every three years, the continued validity of the compensation policy that was determined for a period exceeding three years; (ii) recommend an update the compensation policy from time to time and to examine its implementation; (iii) determine whether to approve the Terms of Service and Employment of Office Holders that require the committee's approval; and (iv) determine whether a transaction is exempt from the requirement for shareholders' approval. The compensation committee also has oversight authority over the actual terms of employment of directors and officers and may make recommendations to the board of directors and the shareholders (where applicable) with respect to deviation from the compensation policy that was adopted by the company.

In accordance with the Israeli Companies Law, our compensation committee must consist of no less than three members, including all of our outside directors (who must constitute a majority of its members of the committee), and that the remainder of the members of the compensation committee be directors whose terms of service and employment were determined pursuant to the applicable regulations. Similar restrictions to the restrictions on the actions and membership in the audit committee, as discussed above under "Audit Committee", are imposed on the compensation committee, with respect to, among other things, the requirement that an outside director serve as the chairman of the committee and the list of persons who may not serve on the committee. We have established a compensation committee that is currently composed of our outside directors, Ms. Varda Trivaks, and Mr. Eytan Barak, and Mr. Yaacov Goldman.

Compensation Policy

In accordance with the Israeli Companies Law, in August 2013, our shareholders approved a compensation policy that must be approved once every three years.

The approval of the compensation policy by our shareholders requires the affirmative vote of the holders of a majority of the shares present, in person or by proxy, and voting on the matter provided that at least one of the following conditions is met: (i) the shares voting in favor of the matter include at least a majority of the shares voted by shareholders who are not controlling shareholders and who do not have a personal interest in the approval of the compensation policy (or the transaction, as the case may be) or (ii) the total number of shares voted against the compensation policy by shareholders referenced under (i) does not exceed 2% of the company's outstanding voting rights. We may approve a compensation policy even in the event it is rejected by the shareholders; provided that the compensation committee and thereafter the board of directors resolve that the approval of the compensation policy is for the benefit of our company.

The board of directors is required to periodically examine the compensation policy and the need for adjustments based on the considerations in determining a compensation policy in the event of a material change in the circumstances prevailing during the adoption of the compensation policy or for other reasons.

Our compensation policy is intended to assist our company to achieve its goals and its work plans with a long term view and to ensure that:

- The interests of the directors and officers of our company will be as close as possible and in the closest possible conformity to the interests of our shareholders.

- We will be able to recruit and retain senior managers who have the ability to lead our company to business success and to confront the challenges we face.

- Our directors and officers will be motivated to achieve a high level of business performance without taking unreasonable risks;

- An appropriate balance will be created between the various components of compensation - fixed components vs. variable components, short-term vs. long-term, and compensation in cash vs. equity based compensation.

The overall compensation of each employee and especially of our officers is based on a number of components, so that each component rewards the employee for a different aspect of his contribution to the company.

- Fixed base salary - intended to compensate the employee for the time spent in carrying out his work for the company and for execution of the ongoing tasks of his position on a daily basis. The base salary represents the employees' skills on one hand (such as: experience, job knowledge, expertise, education, professional qualifications, etc.) and on the other hand, the job requirements and the scope of authority and responsibilities of the employee.

- Social and Incidental Benefits - some of which are statutorily defined (pension savings, severance contributions, loss of work capacity insurance, vacation, sick leave, etc.), some of which reflect standard work market practice (such as savings in education funds in Israel while maximizing the inherent advantages for the employee in the tax benefits offered by the State of Israel) and some of which are intended to supplement the fixed salary and to compensate the employee for expenses incurred in the performance of his work (such as travel costs).

- Variable, Performance Based Rewards (Annual Bonus, Commissions and Grants) - Is intended to compensate the employee for his achievements and contribution to our company's goals during the period for which the variable compensation is paid. In general, the weight ascribed to this component as a part of the total compensation package increases as the employee is in a more senior position.

- Equity based compensation - is intended to tie between the maximization of shareholders' value as expressed in the value of our shares in the long-term and the compensation given to managers and employees of our company. We believe that this compensation creates proximity between the interests of our employees and managers and our shareholders, and thus assists in motivating and retaining the key positions holders in our company.

In order to ensure consistency between all of the compensation components, in their approval deliberations for each of the components of compensation for an officer, the Compensation Committee and the Board of Directors will be presented with the entire compensation package of the officer.

Internal Audit

Under the Israeli Companies Law, the board of directors of a public company must appoint an internal auditor nominated by the audit committee. A person who does not satisfy the Israeli Companies Law's independence requirements may not be appointed as an internal auditor. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business practice. Mr. Doron Cohen of Fahn Kanne & Co., the Israeli member firm of Grant Thornton International Ltd., serves as our internal auditor.

Directors' Service Contracts

There are no arrangements or understandings between us and any of our subsidiaries, on the one hand, and any of our directors, on the other hand, providing for benefits upon termination of their employment or service as directors of our company or any of our subsidiaries.

Approval of Related Party Transactions Under Israeli Law

Fiduciary Duties of Office Holders

The Israeli Companies Law codifies the fiduciary duties that "office holders," including directors and executive officers, owe to a company. An "office holder" is defined in the Israeli Companies Law as a director, general manager, chief business manager, deputy general manager, vice general manager, other manager directly subordinate to the general manager or any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care requires an office holder to act at a level of care that a reasonable office holder in the same position would employ under the same circumstances. This includes the duty to utilize reasonable means to obtain (i) information regarding the appropriateness of a given action brought for his approval or performed by him by virtue of his position and (ii) all other information of importance pertaining to the foregoing actions. The duty of loyalty includes (i) avoiding any conflict of interest between the office holder's position in the company and any other position he holds or his personal affairs, (ii) avoiding any competition with the company's business, (iii) avoiding exploiting any business opportunity of the company in order to receive personal gain for the office holder or others, and (iv) disclosing to the company any information or documents relating to the company's affairs that the office holder has received due to his position as an office holder.

Disclosure of Personal Interests of an Office Holder

The Israeli Companies Law requires that an office holder promptly, and no later than the first board meeting at which such transaction is considered, disclose any personal interest that he or she may have and all related material information known to him or her and any material documents in their possession, in connection with any existing or proposed transaction by us. In addition, if the transaction is an extraordinary transaction, that is, a transaction other than in the ordinary course of business, other than on market terms, or that may have a material impact on the company's profitability, assets or liabilities, the office holder must also disclose any personal interest held by the office holder's "relative" (as defined above), or by any corporation in which the office holder or a relative is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager.

Approval of Transactions with Office Holders

Some transactions, actions and arrangements involving an office holder (or a third party in which an office holder has a personal interest) must be approved by the board of directors and, in some cases, by the audit committee and by the board of directors, and under certain circumstances shareholder approval may also be required, provided, however, that each such transaction is required also to be for the benefit of the company. A director who has a personal interest in a transaction may not be present during the discussions and may not vote on the transaction, unless the transaction does not pertain to terms of service and employment and is not an extraordinary transaction or the majority of the members of the board or the audit committee has a personal interest. In the event the majority of the members of the board of directors have a personal interest, they are entitled to participate in the meeting but the approval of the general meeting of shareholders is also required.

Approval Process of Terms of Service and Employment of Office Holders

The process for approval of Terms of Service and Employment of office holders is as follows:

- With respect to our chief executive officer, a controlling shareholder or a relative of a controlling shareholder, approval is required by the (i) Compensation Committee, (ii) board of directors and (iii) company's shareholders with the "special majority" described above (in that order). Subject to certain conditions, the Israeli Companies Law provides an exemption from the shareholder approval requirement in connection with the approval of the Terms of Service and Employment of a CEO candidate.

- With respect to a director, approval is required by the (i) compensation committee, (ii) board of directors and (iii) company's shareholders with a regular majority (in that order).

- With respect to any other office holder, approval is required by the Compensation Committee and the board of directors (in that order); however, in the event of an update of existing Terms of Service and Employment, which the Compensation Committee confirms is not material, Compensation Committee approval is sufficient.

In the event the transaction with any office holder is not in accordance with the compensation policy, the approval of the company's shareholders, by "special majority," is also required. In the event the company's shareholders do not approve the compensation of the CEO or other office holders (who are not directors, controlling shareholders or relatives of the controlling shareholders), the Compensation Committee and board of directors may, in special situations, approve the transaction, subject to their providing detailed reasons and after discussion and examination of the rejection by the company's shareholders.

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Disclosure of Personal Interests of a Controlling Shareholder; Approval of Transactions with Controlling Shareholders

The disclosure requirements that apply to an office holder also apply to a transaction in which a controlling shareholder of the company has a personal interest. The Israeli Companies Law provides that an extraordinary transaction with a controlling shareholder or an extraordinary transaction with another person in which the controlling shareholder has a personal interest or a transaction with a controlling shareholder or his relative regarding terms of service and employment, must be approved by the audit committee, the board of directors and shareholders. The shareholders' approval of such a transaction requires a simple majority approval and the fulfillment of one of the following conditions: (i) at least a majority of the votes cast by shareholders who have no personal interest in the transaction and who vote on the matter are voted in favor of the transaction, or (ii) the votes cast by shareholders who have no personal interest in the transaction voted against the transaction do not represent more than two percent of the voting rights in the company. In addition, any such transaction with a term that exceeds three years requires approval as described above every three years, unless (with respect only to extraordinary transactions and not to other transactions that require the special approval process) the audit committee approves that a longer term is reasonable under the circumstances.

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

Exculpation, Indemnification and Insurance of Directors and Officers

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

Insurance of Office Holders. Israeli law provides that a company may, if permitted by its articles of association, enter into a contract to insure its office holders for liabilities incurred by the office holder with respect to an act or omission performed in his or her capacity as an office holder, as a result of: (i) a breach of the office holders duty of care to the company or another person; (ii) a breach of the office holders duty of loyalty to the company, provided that the office holder acted in good faith and had reasonable cause to assume that the act would not prejudice the company's interests; and (iii) a financial liability imposed upon the office holder in favor of another person.

Indemnification of Office Holders. Under Israeli law a company may, if permitted by its articles of association, indemnify an office holder for acts or omissions performed by the office holder in such capacity for (a) monetary liability imposed upon the office holder in favor of another person pursuant to a court judgment, including a

settlement or an arbitration award approved by a court; (b) reasonable litigation expenses, including attorney's fees, actually incurred by the office holder as a result of an investigation or proceeding instituted against him or her by a competent authority, provided that such investigation or proceeding concluded without the filing of an indictment against the office holder or the imposition of any monetary liability in lieu of criminal proceedings, or concluded without the filing of an indictment against the office holder and a monetary liability was imposed on him or her in lieu of criminal proceedings with respect to a criminal offense that does not require proof of criminal intent; and (c) reasonable litigation expenses, including attorneys' fees, actually incurred by the office holder or imposed upon the office holder by a court: (i) in an action, suit or proceeding brought against the office holder by or on behalf of the company or another person, (ii) in connection with a criminal action in which the office holder was acquitted, or (iii) in connection with a criminal action in which the office holder was convicted of a crime that does not require proof of criminal intent.

Israeli law provides that a company's articles of association may permit the company to (a) indemnify an office holder retroactively, following a determination to this effect made by the company after the occurrence of the event in respect of which the office holder will be indemnified; and (b) undertake in advance to indemnify an office holder, except that with respect to a monetary liability imposed on the office holder by any judgment, settlement or court-approved arbitration award, the undertaking must be limited to types of occurrences, which, in the opinion of the company's board of directors, are, at the time of the undertaking, foreseeable due to the company's activities and to an amount or standard that the board of directors has determined is reasonable under the circumstances.

Limitations on Exculpation, Insurance and Indemnification. The Israeli Companies Law provides that a company may not exempt or indemnify an office holder nor enter into an insurance contract which would provide coverage for liability incurred as a result of any of the following: (a) a breach by the office holder of his or her duty of loyalty (however, a company may insure and indemnify against such breach if the office acted in good faith and had reasonable cause to assume that his act would not prejudice the company's interests); (b) a breach by the office holder of his or her duty of care if the breach was done intentionally or recklessly, unless made in negligence only; (c) any act of omission done with the intent to derive an illegal personal benefit; or (d) any fine, civil fine, monetary sanction or penalty levied against the office holder.

The term "office holder" of a company includes a director, general manager, chief business manager, deputy general manager, vice general manager, or any person filling any of these positions in a company even if he or she holds a different title, and also includes any other manager directly subordinate to the general manager.

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

Our Articles of Association allow us to insure, indemnify and exempt our office holders, to the fullest extent permitted by the provisions of the Israeli Companies Law. We maintain a directors' and officers' liability insurance policy with a per claim and aggregate coverage limit of $6.25 million, including legal costs incurred in Israel. We have provided several of our directors and officers a letter of indemnification for liabilities or expenses incurred as a result of their acts in their capacity as directors and officers of our company, in an aggregate amount not to exceed $3 million.

Administrative Sanctions. The Israeli Securities Authority is authorized to impose administrative sanctions against companies like ours and their office holders for certain violations of the Israeli Securities Law or the Israeli Companies Law. These sanctions include monetary sanctions and certain restrictions on serving as a director or senior officer of a public company for certain periods of time. The maximum amount of the monetary sanctions that could be imposed upon individuals is a fine of NIS 1.0 million (currently equivalent to approximately $260,000), plus the greater of the following amounts payable to persons who suffered damages as a result of the violation: (i) the amount of profits earned or losses avoided by the violator as a result of the violation, up to the amount of the applicable fine, or (ii) compensation for damages suffered by the injured persons, up to 20% of the fine imposed on the violator.

Only certain types of liabilities may be reimbursed by indemnification and insurance. Specifically, legal expenses (including attorneys' fees) incurred by an individual in the applicable administrative enforcement proceeding and any compensation payable to injured parties for damages suffered by them (as described in clause (ii) of the immediately preceding paragraph) are permitted to be reimbursed via indemnification or insurance, provided that such indemnification and insurance are authorized by the company's articles of association.

D. Employees

On December 31, 2013, we and our consolidated subsidiaries employed 59 persons, of which 12 persons were employed in research and development, 20 in training and technical support, 11 in sales and marketing and 16 in operations and administration. As of December 31, 2013, 23 of our employees were located in Israel, 34 of our employees were located in the United States and 2 of our employees were located in Hong Kong.

On December 31, 2012, we and our consolidated subsidiaries employed 75 persons, of which 12 persons were employed in research and development, 33 in training and technical support, 13 in sales and marketing and 17 in operations and administration. As of December 31, 2012, 26 of our employees were located in Israel, 45 of our employees were located in the United States and 4 of our employees were located in Hong Kong.

On December 31, 2011, we and our consolidated subsidiaries employed 78 persons, of which 15 persons were employed in research and development, 33 in training and technical support, 10 in sales and marketing and 20 in operations and administration. As of December 31, 2011, 28 of our employees were located in Israel, 46 of our employees were located in the United States and 4 of our employees were located in Hong Kong.

Certain provisions of the collective bargaining agreements between the General Federation of Labor in Israel, or the Histadrut, and the Coordination Bureau of Economic Organizations (including the Industrialists Association) are applicable to our employees by order of the Israeli Ministry of Labor. These provisions concern mainly the length of the workday, minimum daily wages for professional workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. We generally provide our employees with benefits and working conditions beyond the minimum requirements.

Cost of living adjustment of employees' wages is determined on a nationwide basis and is legally binding, if and when applied. Israeli employers and employees are required to pay predetermined amounts to the National Insurance Institute, which is similar to the United States Social Security Administration and additional sums towards compulsory health insurance. In 2013, payments to the National Insurance Institute amounted to approximately 15% of wages, of which approximately two-thirds was contributed by employees with the balance contributed by the employer.

Pursuant to Israeli law, we are required to pay severance benefits upon certain circumstances, including the retirement or death of an employee or the termination of employment of an employee without due cause. Pursuant to an order issued in December 2007 by the Israeli Minister of Industry, Trade and Labor, new provisions relating to pension arrangements in the collective bargaining agreements between the Histadrut and the Coordination Bureau of Economic Organizations apply to all employees in Israel. According to such provisions, all employees employed in Israel for at least six months are entitled to pension benefits to be funded by preset monthly contributions of the employee and the employer and to certain severance benefits regardless of whether they or we terminated their employment. We partly satisfy this obligation by contributing approximately 8.3% of between 80%-100% of the employee's annual gross salary to a fund known as "Managers' Insurance" or to pension fund. This fund provides a combination of savings plans, insurance and severance pay benefits to the employee, giving the employee a lump sum payment upon retirement and a severance payment, if legally entitled, upon termination of employment. The remaining part of this obligation is presented in our balance sheet as the difference between the "accrued severance pay" and "severance pay fund."

E. Share Ownership

The following table sets forth certain information as of March 12, 2014 regarding the beneficial ownership of our ordinary shares by each of our directors and all of our executive officers and directors as a group:.

Name	Number of Ordinary Shares Beneficially Owned (1)		Percentage of Outstanding Ordinary Shares (2)	
Chaim Mer	1,112,654	(3)	23.8	%
Isaac Ben-Bassat	344,607	(4)	7.4	%
Eytan Barak	--		--	
Roger Challen	992,708	(5)	21.3	%
Steven J. Glusband	500		*	
Yaacov Goldman	--		--	

Ms. Varda Trivaks	--	--	
All executive officers and directors as a group (10 persons)	2,619,219 (6)	54.2	%

* Less than 1%.

(1) Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Ordinary shares relating to options currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them. The number of ordinary shares beneficially owned set forth in the table and the footnotes to the table have been adjusted to reflect the one-for-two reverse stock split that was effected on March 2, 2010.

(2) The percentages shown are based on 4,665,557 ordinary shares (excluding 5,400 ordinary shares held as treasury stock) issued and outstanding as of March 12, 2014.

(3) Based upon a Schedule 13D/A filed with the SEC on May 26, 2009 and other information available to our company. Mr. Chaim Mer and his wife, Mrs. Dora Mer, are the record holders of 234,610 ordinary shares and the beneficial owners of 872,226 ordinary shares through their controlling interest in Mer Ofekim Ltd., 5,770 ordinary shares through their controlling interest in Mer Services Ltd. and 48 ordinary shares through their controlling interest in Mer & Co. (1982) Ltd.

(4) Based upon a Schedule 13D/A filed with the SEC on October 30, 2008 and other information available to our company. Includes 29,584 ordinary shares owned of record by Mr. Ben-Bassat and 315,023 ordinary shares owned of record by Ron Dan Investments Ltd., a company controlled by Mr. Ben-Bassat.

(5) Based upon a Schedule 13D filed by Mr. Roger Challen and The Info Group, Inc. with the SEC on September 6, 2012 and other information available to our company. The 992,708 ordinary shares are held of record by The Info Group, Inc., a Massachusetts corporation controlled by Mr. Roger Challen. Accordingly, Mr. Roger Challen may be deemed to have the sole voting and dispositive power as to the ordinary shares held of record by The Info Group, Inc.

(6) Includes 168,750 ordinary shares subject to options granted under our 2003 Israeli Share Option Plan and 2006 Option Plan that are currently exercisable or exercisable within 60 days of the date of this table.

Stock Option Plans

2003 Israeli Share Option Plan

In August 2013, our shareholders approved amendments to the 2003 Israeli Share Option Plan, or the 2003 Plan. Its term was extended by ten years so that the 2003 Plan will expire on November 30, 2023, unless further extended. The number of ordinary shares issuable under the 2003 Plan was increased by an additional 500,000 ordinary shares, so that we are entitled to issue up to 946,957 ordinary shares under the 2003 Plan. Options granted under the 2003 Plan are not assignable or transferable by an optionee, other than by will or by laws of descent and distribution, and during the lifetime of an optionee may be exercised only by the optionee or by the optionee's legal representative. Such options may be exercised as long as the optionee is employed by, or providing services to us or any of our affiliates, to the extent the options have vested and, under certain circumstances set forth in the 2003 Plan, for a period of 90 days thereafter. The Board of Directors or the stock option committee, as the case may be, may permit options to continue to be in effect following the termination of employment, so long as the resolution is adopted prior to expiration of the options as a result of termination and there is no change in the original expiration date of the options.

During 2013, 186,000 options were granted under the 2003 Plan and 35,250 options were exercised. At December 31, 2013, options to purchase 287,250 ordinary shares were outstanding under the 2003 Plan, exercisable at an average exercise price of $2.03 per share.

2006 Stock Option Plan

In June 2006, we adopted our 2006 Stock Option Plan, or the 2006 Plan, under which up to 200,000 post-reverse split ordinary shares may be issued (subject to standard adjustments) to employees, officers and non-employee directors of ours and our affiliates. Ordinary shares as to which an option granted under the 2006 Plan has not been exercised at the time of its expiration, cancellation or forfeiture may again be subject to new awards under the 2006 Plan. At our 2011 annual general meeting, our shareholders approved an amendment to our 2006 Stock Option Plan to provide for

the issuance thereunder of an additional 200,000 post-reverse split ordinary shares and to increase the total number of ordinary shares with respect to which options may be granted thereunder to any eligible employee during any 12 month period to 150,000 (instead of 50,000 according to the original 2006 Plan) ordinary shares, subject to adjustment as provided in the 2006 Plan. At our 2013 annual general meeting, our shareholders approved an amendment to our 2006 Stock Option Plan to provide for the issuance thereunder of an additional 150,000 post-reverse split ordinary shares, such that we will be entitled to issue options to purchase up to 550,000 ordinary shares under the 2006 Plan.

The 2006 Plan will be administered by our Board of Directors or to the extent permitted by Israeli law, a Compensation Committee of our Board of Directors. All references below to the "Committee" refer to the Board of Directors or compensation committee established by our Board of Directors, as applicable. The Committee will have the authority, in its discretion, to establish from time to time guidelines or regulations for the administration of the 2006 Plan, to interpret the 2006 Plan, and to make all determinations it considers necessary or advisable for the administration of the 2006 Plan, in addition to the other responsibilities and powers assigned to the Committee in the 2006 Plan. All decisions, actions or interpretations of the Committee under the 2006 Plan will be final, conclusive and binding upon all parties.

Each option granted under the 2006 Plan will be either an option intended to be treated as an "incentive stock option," within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, or the Code, or an option that will be treated as a "non-qualified stock option." No incentive stock may be granted to any individual who is not an eligible employee of our company or a "subsidiary" within the meaning of the Code. No incentive stock option may be granted to an employee if, as of the date of grant of such option, such employee owns stock possessing more than ten percent of the total combined voting power of all classes of stock of our company or any affiliated company, a "10% Holder," unless (a) the exercise price per share under such option is at least 110% of the fair market value of an ordinary share determined as of the date of grant of such option, and (b) such option is not exercisable after the expiration of five years from the date of grant of such option. No incentive stock option may be granted under the 2006 Plan after the ten year anniversary of its adoption.

In no event may the term of any option exceed ten years from the date of grant of the option. However, in no event may the term of any option granted to a 10% Holder exceed five years from the date of grant of the option. No option may be exercised after its expiration.

Each option granted under the 2006 Plan will become exercisable, in whole or in part, at such time or times during its term as the instrument evidencing the grant of such option may specify.

The price at which ordinary shares may be purchased upon any exercise of an option granted under the 2006 Plan will be the price per share determined by the Committee, and specified in the instrument evidencing the grant of such option, but in no event may the exercise price per share be less than (i) the fair market value of an ordinary share determined as of the date of grant of the option, or (ii), if greater, the par value of an ordinary share. However, with respect to an option granted to a 10% Holder, in no event may the exercise price per share be less than 110% of the fair market value of our ordinary shares determined as of the date of grant of such option.

Options granted under the 2006 Plan are nontransferable, other than by will or the laws of descent and distribution, and may be exercised during the grantee's lifetime only by the grantee. However, if the instrument evidencing the grant of an option other than an incentive stock option so provides, the grantee may transfer his or her rights with respect to such option or any portion thereof, without consideration, to any "family member," as such term is defined in the 2006 Plan.

The terms and conditions of an option grant may not be waived or amended without the consent of the grantee if it would adversely affect, to any material extent, any of the rights or obligations of the grantee with respect to such grant, or in the case of any option that was intended to constitute an incentive stock option, if such waiver or amendment would cause such option to fail to be treated as an incentive stock option.

Our Board of Directors may, with prospective or retroactive effect, amend, suspend or terminate the 2006 Plan or any portion of the 2006 Plan at any time. However, no amendment, suspension or termination of the 2006 Plan may adversely affect the rights of any grantee with respect to any options previously granted to the grantee without his or her written consent. Also, no amendment which constitutes a "material revision" of the 2006 Plan, within the meaning

of such term under NASDAQ rules, may be effective unless approved by our shareholders in the manner required by such rules and by applicable law.

In August 2013, our shareholders approved an amendment to the 2006 Plan. The number of ordinary shares issuable under the 2006 Plan was increased by an additional 150,000 ordinary shares, so that we are entitled to issue up to 550,000 ordinary shares under the 2006 Plan.

During 2013, 16,000 options were granted under the 2006 Plan and no options were exercised. At December 31, 2013, options to purchase 158,500 ordinary shares were outstanding under the 2006 Plan, exercisable at an average exercise price of $1.62 per share.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

The following table sets forth certain information as of March 12, 2014 regarding the beneficial ownership by all shareholders known to us to own beneficially 5.0% or more of our ordinary shares:

Name	Number of Ordinary Shares Beneficially Owned(1)	Percentage of Outstanding Ordinary Shares(2)
Chaim Mer and Dora Mer	1,112,654 (3)	23.8 %
Roger Challen	992,708 (4)	21.3 %
Isaac Ben-Bassat	344,607 (5)	7.4 %

(1) Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Ordinary shares relating to options currently exercisable or exercisable within 60 days of the date of this table are deemed outstanding for computing the percentage of the person holding such securities but are not deemed outstanding for computing the percentage of any other person. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them. The number of ordinary shares beneficially owned set forth in the table and the footnotes to the table have been adjusted to reflect the one-for-two reverse stock split that was effected on March 2, 2010.

(2) The percentages shown are based on 4,665,557 ordinary shares (excluding 5,400 ordinary shares held as treasury stock) issued and outstanding as of March 12, 2014.

(3) Based upon a Schedule 13D/A filed with the SEC on May 26, 2009 and other information available to our company. Mr. Chaim Mer and his wife, Mrs. Dora Mer, are the record holders of 234,610 ordinary shares and the beneficial owners of 872,226 ordinary shares through their controlling interest in Mer Ofekim Ltd., 5,770 ordinary shares through their controlling interest in Mer Services Ltd. and 48 ordinary shares through their controlling interest in Mer & Co. (1982) Ltd.

(4) Based upon a Schedule 13D filed by Mr. Roger Challen and The Info Group, Inc. with the SEC on September 6, 2012 and other information available to our company. The Info Group, Inc. is a Massachusetts corporation controlled by Mr. Roger Challen. Accordingly, Mr. Roger Challen may be deemed to have the sole voting and dispositive power of our ordinary shares held of record by The Info Group, Inc.

(5) Based upon a Schedule 13D/A filed with the SEC on October 30, 2008 and other information available to our company. Includes 29,584 ordinary shares owned of record by Mr. Ben-Bassat and 315,023 ordinary shares

owned of record by Ron Dan Investments Ltd., a company controlled by Mr. Ben-Bassat.

Significant Changes in the Ownership of Major Shareholders

On August 29, 2012, Mr. Lior Salansky, who was a director, filed a Schedule 13D/A with the SEC reflecting that he sold all the 554,281 ordinary shares held by him since 2008.

Major Shareholders Voting Rights

Our major shareholders do not have different voting rights.

Record Holders

Based on a review of the information provided to us by our transfer agent, as of March 7, 2014, there were 111 holders of record of our ordinary shares, of which 65 record holders holding approximately 71.08% of our ordinary shares had registered addresses in the United States. These numbers are not representative of the number of beneficial holders of our shares nor are they representative of where such beneficial holders reside, since many of these ordinary shares were held of record by brokers or other nominees (including one U.S. nominee company, CEDE & Co., which held approximately 47.97% of our outstanding ordinary shares as of such date).

B. Related Party Transactions

C. Mer is a publicly traded company in which Mr. Chaim Mer, the Company's chairman of the board and Mr. Isaac Ben Bassat, a director of the Company, are members of the controlling group. Mr. Mer has been the Chairman of Board of Directors of C. Mer since 1988 and served as its President and Chief Executive Officer from 1988 until January 2005. Presently, the only service provided to us by C. Mer is our participation in its umbrella liability insurance coverage. We believe that the terms under which C. Mer provides such participation to us is on a basis no less favorable than could be obtained from an unaffiliated third party. In 2012, we engaged with Mer Telecom Ltd., a subsidiary of C. Mer, in a deployment of a Mobile Financial Services (MFS) solution for a customer in Africa in a revenue share model with a minimum total value of $460,000 over a three year period. The transaction was approved by our board of directors and we completed its deployment in 2013 and received the setup fee of $100,000. As of December 31, 2013, the solution was implemented, but the customer has not as yet activated the solution.

Beginning January 1, 2009 and as part of the acquisition of certain assets and liabilities of the telecommunications expense management solutions business of AnchorPoint (now known as The Info Group Inc.), Mr. Roger Challen, the controlling shareholder and chief executive officer of AnchorPoint, was employed by our company at an annual salary of $77,760. We terminated such employment relationship effective as of June 30, 2011, and instead, our shareholders authorized his provision of consultancy services to us at a monthly cost of $2,000. As we did not enter into a consulting agreement with Mr. Challen, nor were consulting fees paid, our audit committee, Board of Directors and shareholders approved the payment of fees to him effective from January 1, 2012 and for the duration of his service as a non-employee director. The fees are equivalent to the fees we pay to our other non-employee directors for their service in such capacity (an annual fee of $8,400 and a per meeting attendance fee of $300). Mr. Challen also receives reimbursement of travel related expenses in connection with his attendance of Board of Directors' meetings, pursuant to guidelines for reimbursement of director travel related expenses approved by our audit committee and Board of Directors. In addition, since January 1, 2009 and as part of the acquisition of certain assets and liabilities of AnchorPoint's TEM solutions, we also received certain services from Data Distributors, Inc., a company controlled by Mr. Challen. These services include reimbursement for shared expenses, development and IT services, other administrative services and rental related fees. These services were significantly reduced during 2011 and reduced further in 2012 and in 2013. Expenses recognized with respect to the above mentioned services were approximately $195,000, $0 and $0 for the year ended December 31, 2011, 2012 and 2013, respectively. In addition, we rent from Mr. Challen an office in Powder Springs, Georgia, where we occupy approximately 4,800 square feet of space under a month-to-month lease, for a monthly rental fee of approximately $4,700. Mr. Challen is the controlling shareholder of the Info Group Inc., which is the beneficial owner of 21.3% of our ordinary shares.

On March 25, 2009, our audit committee and Board of Directors approved a transaction with Mer & Co. (1982) Ltd., or Mer & Co., a subsidiary of C. Mer, that is an approved supplier of the Israeli Defense Forces. According to the

terms of the transaction, we sell our products to Mer & Co., which then represents us and resells our products to the Israeli Defense Forces. For these services, we agreed to pay Mer & Co. 5% of the amounts we receive from the Israeli Defense Forces for our products; however, as of December 31, 2013, Mer & Co. has provided such services without charge.

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

Financial Statements

See the consolidated financial statements, including the notes thereto included in Item 18.

Export Sales

See Note 12 of our consolidated financial statements.

Legal Proceedings

In April 2000, the tax authorities in Israel issued us a demand for a tax payment of approximately NIS 6.0 million for the 1997 to 1999 period. We appealed to the Tel-Aviv District Court and in October 2012, the Court rendered its decision, according to which, our claims were partly accepted and partly rejected. The assessment required us to increase the provision previously made in our financial statements. In December 2012, we made an advance payment of NIS 4.5 million (approximately $1.2 million) to the tax authorities. In February 2013, we received a formal final assessment from the tax authorities and paid the remaining amount due of approximately $240,000.

During August 2007, our now inactive Brazilian subsidiary, TABS Brazil Ltda., was ordered by the Labor Law Court in Brazil to pay approximately 167,000 Brazilian Reais (approximately $71,000) to one of its former employees. Such amount bears interest at a rate of 1% per month from the date that the claim was filed. We recorded a provision in our financial statements for the amount deemed probable.

We are a party to various other claims that arise in the ordinary course of business. Accordingly, we have recorded a provision of approximately $225,000 in respect of such claims in accordance with ASC 450, “Contingencies,” based on the opinion of our management and legal advisors.

Dividend Distribution Policy

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

According to the Israeli Companies Law, a company may distribute dividends out of its profits (as such term is defined in the Israeli Companies Law), provided that there is no reasonable concern that payment of the dividend will prevent the company from satisfying all its current and foreseeable obligations, as they become due. Notwithstanding the foregoing, dividends may be paid with the approval of a court, at the company’s request, provided that there is no reasonable concern that payment of the dividend will prevent the company from satisfying its current and foreseeable obligations, as they become due. In the event cash dividends are declared, such dividends will be paid in NIS.

B. Significant Changes

Except as otherwise disclosed in this annual report, no significant change has occurred since December 31, 2013.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

As of March 2, 2010, we effected a one-for-two reverse stock split of our issued and outstanding ordinary shares, following the approval of our shareholders at an extraordinary general meeting. Immediately following the reverse stock split, 4,464,457 ordinary shares were issued and 4,459,057 ordinary shares were outstanding. The share prices set forth below have been adjusted retroactively to reflect the reverse stock split.

Annual Stock Information

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

Year	High	Low
2013	$ 5. 11	$ 1.55
2012	$ 3.99	$ 1.37
2011	$ 2. 14	$ 1. 15
2010	$ 4. 00	$ 0. 60
2009	$ 4. 78	$ 1. 20

Quarterly Stock Information

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

	High	Low
2012		
First Quarter	$ 2. 14	$ 1. 37
Second Quarter	$ 2. 04	$ 1. 50
Third Quarter	$ 3. 30	$ 1. 51
Fourth Quarter	$ 3. 99	$ 2. 50
2013		
First Quarter	$ 5. 11	$ 2. 47
Second Quarter	$ 2. 71	$ 1. 55
Third Quarter	$ 2. 27	$ 1. 55
Fourth Quarter	$ 2. 75	$ 1. 67
2014		
First Quarter (through March 10)	$ 2. 63	$ 1. 74

Monthly Stock Information

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

Month	High	Low
October 2013	$ 2. 70	$ 1. 67
November 2013	$ 2. 52	$ 1. 97
December 2013	$ 2. 75	$ 2. 37
January 2014	$ 2. 63	$ 1. 90
February 2014	$ 1. 90	$ 1. 78
March 2014 (through March 10)	$ 1. 79	$ 1. 74

B. Plan of Distribution

Not applicable.

C. Markets

Our ordinary shares were listed on the NASDAQ Global Market (formerly the NASDAQ National Market) in connection with our initial public offering on May 21, 1997. On December 23, 1998, the listing of our ordinary shares was transferred to the NASDAQ Capital Market (symbol: MTSL).

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expense of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

Set out below is a description of certain provisions of our Articles of Association and of the Israeli Companies Law related to such provisions. This description is only a summary and does not purport to be complete and is qualified by reference to the full text of the Articles of Association, which are incorporated by reference as exhibits to this Annual Report, and to Israeli law.

Purposes and Objects of the Company

We are a public company registered under the Israel Companies Law, 1999-5759, or the Israeli Companies Law, as MER Telemanagement Solutions Ltd., registration number 520042904. Our objects and purposes, as provided by our Articles of Association, are to carry on any lawful activity.

The Powers of the Directors

Under the provisions of the Israeli Companies Law and our Articles of Association, a director cannot participate in a meeting nor vote on a proposal, arrangement or contract in which he or she is materially interested, unless the majority of the Board of Directors or relevant committee, as the case may be, has a personal interest in the transaction. In addition, our directors cannot approve compensation to themselves or any members of their body without the approval of our compensation committee and our shareholders at a general meeting. See Item 6C. “Directors, Senior Management and Employees – Board Practices – Compensation Committee.”

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

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

Rights Attached to Shares

Our authorized share capital consists of 12,000,000 ordinary shares of a nominal value of NIS 0.01 each. All outstanding ordinary shares are validly issued, fully paid and non-assessable.

The rights attached to the ordinary shares are as follows:

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

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

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

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

Pursuant to our Articles of Association, our directors (other than outside directors) are elected at our annual general meeting of shareholders by a vote of the holders of a majority of the voting power represented and voting at such meeting and hold office until the next annual general meeting of shareholders and until their successors have been elected. All the members of our Board of Directors (except the outside directors who generally have a limitation of three three-year terms) may be reelected upon completion of their term of office. For information regarding the election of outside directors, see Item 6C. “Directors, Senior Management and Employees – Board Practices – Election of Directors - Outside and Independent Directors - Outside Directors.”

Rights to share in our company’s profits. Our shareholders have the right to share in our profits distributed as a dividend and any other permitted distribution. See this Item 10B. “Additional Information – Memorandum and Articles of Association – Rights Attached to Shares – Dividend Rights.”

Rights to share in surplus in the event of liquidation. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to the nominal value of their holdings. This right may be affected by the grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

Liability to capital calls by our company. Under our memorandum of association and the Israeli Companies Law, the liability of our shareholders is limited to the par value of the shares held by them.

Limitations on any existing or prospective major shareholder. See Item 6C. “Directors and Senior Management –Board Practices - Approval of Related Party Transactions Under Israeli Law.”

Changing Rights Attached to Shares

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

Annual and Extraordinary Meetings

Under the Israeli Companies Law a company must convene an annual meeting of shareholders at least once every calendar year and within 15 months of the last annual meeting. Depending on the matter to be voted upon, notice of up to 35 days prior to the date of the meeting is required. Our board of directors may, in its discretion, convene additional meetings as "special general meetings." In addition, the board must convene a special general meeting upon the demand of two of the directors or 25% of the directors, one or more shareholders holding at least 5% of the outstanding share capital and at least 1% of the voting power in the company, or one or more shareholders holding at least 5% of the voting power in the company. See Item 10B. "Additional Information - Memorandum and Articles of Association - Rights Attached to Shares - Voting Rights."

Limitations on the Rights to Own Securities in Our Company

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

Provisions Restricting Change in Control of Our Company

Tender Offer

The Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a 25% or greater shareholder of the company. This rule does not apply if there is already another 25% or greater shareholder of the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would hold greater than a 45% interest in the company, unless there is another shareholder holding more than a 45% interest in the company. These requirements do not apply if, in general, the acquisition: (1) was made in a private placement that received shareholder approval as a private placement and was meant to grant the purchaser 25% or more of the voting rights of a company in which no other shareholder holds 25% or more of the voting rights, or to grant the purchaser more than 45% of the voting rights of a company in which no other shareholder holds more than 45% of the voting rights, (2) was from a 25% or greater shareholder of the company which resulted in the acquiror becoming a 25% or greater shareholder of the company, or (3) was from a shareholder holding more than a 45% interest in the company which resulted in the acquiror becoming a holder of more than a 45% interest in the company.

If, as a result of an acquisition of shares, the acquiror will hold more than 90% of a company's outstanding shares, the acquisition must be made by means of a tender offer for all of the outstanding shares, or a full tender offer. A full tender offer is accepted if either: (i) holders of less than 5% of the outstanding shares do not accept the tender offer and more than half of the offerees who do not have a personal interest in accepting the tender offer accepted it, or (ii) holders of less than 2% of the outstanding shares do not accept the tender offer. If the full tender offer is not accepted, then the acquiror may not acquire shares in the tender offer that will cause his shareholding to exceed 90% of the outstanding shares.

The Companies Law provides for appraisal rights in the event a full tender offer is accepted if the shareholder files a request with the court within six months following the consummation of a full tender offer. The acquirer may provide in the tender offer documents that any shareholder that accepted the offer and tendered his shares will not be entitled to appraisal rights.

Merger

The Israeli Companies Law permits merger transactions if approved by each party's board of directors and, except under certain circumstances specified below, by the majority of each party's shares voted on the proposed merger at a shareholders meeting convened upon prior notice of at least 35 days (which may be shortened to 14 days in certain circumstances). The Israeli Companies Law provides that a company that was incorporated prior to the enactment of the Israeli Companies Law, such as us, will be deemed to have a provision in its articles of association requiring a majority of 75% of the shareholders participating and voting on the matter for purposes of approval of a merger. A merger is defined as the transfer of all assets and liabilities, including conditional, future, known and unknown debts of the target company to the surviving company, as a result of which the target company is liquidated, and stricken out of the Companies Register.

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Under the Israeli Companies Law, if one of the merging companies, or a shareholder that holds 25% or more of the means of control of one of the merging companies, or a 25% shareholder, holds shares of the other merging company, then a dissenting vote of holders of the majority of the shares of the other merging company present and voting, excluding shares held by the merging company or a 25% shareholder thereof, or by anyone acting on behalf of either of them, their relatives and corporations controlled by them, is sufficient to reject the merger transaction. Means of control are defined as any of the following: (i) the right to vote at a general meeting of a company; and (ii) the right to appoint a director of a company. If the transaction would have been approved but for the exclusion of the votes as previously indicated, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of the company. The court will not approve a merger unless it is convinced that the merger is fair and reasonable, taking into account the values of the merging companies and the consideration offered to the shareholders. Upon the request of a creditor of either party to the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of the merged company. In addition, a merger may not be completed unless at least 50 days have passed from the date that a proposal for approval of the merger was filed with the Israeli Registrar of Companies and 30 days have passed from the date that shareholder approval of both merging companies was obtained.

Notwithstanding the foregoing, a merger is not subject to the approval of the shareholders of the target company if the target company is a wholly-owned subsidiary of the surviving company. In addition, a merger is not subject to the approval of the shareholders of the surviving company if:

- the merger does not require the alteration of the memorandum or articles of association of the surviving company;
- the surviving company would not issue more than 20% of the voting rights thereof in the course of the merger and no person will become, as a result of the issuance, a controlling shareholder of the surviving company (for this purpose any securities convertible into shares of the surviving company that such person holds or that are issued to him in the course of the merger are deemed to have been converted or exercised);
- neither the target company, nor any shareholder that holds 25% of the means of control of the target company is a shareholder of the surviving company; and
- there is no person that holds 25% or more of the means of control in both companies.

Disclosure of Shareholders Ownership

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

Changes in Our Capital

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

C. Material Contracts

None.

D. Exchange Controls

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares.

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

E. Taxation

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

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

Israeli Tax Considerations

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

General Corporate Tax Structure

Generally, Israeli companies are subject to "Corporate Tax" at their taxable income. The Israeli corporate tax rate was, 24% in 2011, 25% in 2012 and remained 25% in 2013. The corporate tax rate has been increased to 26.5% in 2014. In view of this increase in the corporate tax rate since 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly.

Controlled Foreign Companies

Under the controlled foreign companies rules an Israeli company may become subject to Israeli taxes (as deemed dividends) on non-distributed profits of a non-Israeli subsidiary if the subsidiary’s primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains) and if the taxes imposed outside of Israel are no more than 15% of the profits.

Tax Benefits Under the Law for the Encouragement of Capital Investments, 1959

The Law for the Encouragement of Capital Investments, 1959, commonly referred to as the Investment Law, provides that a proposed capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry, Trade and Labor of the State of Israel, be designated as an approved enterprise. Each certificate of approval for an approved enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, e.g., the equipment to be purchased and utilized pursuant to the program. An approved enterprise is entitled to benefits including Israeli Government cash grants and tax benefits in specified development areas. The tax benefits derived from any such certificate of approval relate only to taxable income attributable to the specific approved enterprise. If a company has more than one approval or only a portion of its capital investments is approved, its effective tax rate is the result of a weighted average of the applicable rates.

Taxable income of a company derived from an approved enterprise is subject to corporate tax at the maximum rate of 25% (rather than the regular corporate tax rate) for the benefit period. This period is ordinarily seven years (or 10

years if the company qualifies as a foreign investors' company as described below) commencing with the year in which the approved enterprise first generates taxable income, and is limited to 12 years from commencement of production or 14 years from the date of approval, whichever is earlier, referred to as "the years limitation." Tax benefits under the Investments Law also apply to income generated 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. The Investment Law also provides that a company that has an approved enterprise within Israel will be eligible for a reduced tax rate and is entitled to claim accelerated depreciation on buildings, machinery and equipment used by the approved enterprise during the first five years of use.

A company owning an approved enterprise may elect to forego entitlement to the grants otherwise available under the Investment Law and in lieu thereof participate in an alternative track of benefits. Under the alternative track of benefits, a company's undistributed income derived from an approved enterprise will be exempt from company tax for a period of two years from the first year of taxable income and such company will be eligible for a reduced tax rate for the remainder, if any, of the otherwise applicable benefits period.

A company that has an approved enterprise program is eligible for further tax benefits if it qualifies as a foreign investors' company. A foreign investors' company is a company that more than 25% of its share capital and combined share and loan capital is owned by non-Israeli residents. A company, which qualifies as a foreign investors' company and has an approved enterprise program is eligible for tax benefits for a ten-year benefit period. The company tax rate applicable to income from the approved enterprise earned in the benefit period (distributed or not) is as follows:

For a company with foreign investment of	The company tax rate is	
over 25% but less than 49%	25	%
49% or more but less than 74%	20	%
74% or more but less than 90%	15	%
90% or more	10	%

In addition, the dividend recipient is taxed at the reduced rate applicable to dividends from approved enterprises income (15%), if the dividend, deriving from the approved enterprises, is distributed during the tax benefit period or within 12 years thereafter, yet, no time limit is applicable to dividends from a foreign investment company. The company must withhold this tax at source, regardless of whether the dividend is converted into foreign currency. However, if retained tax-exempt income is distributed in a manner other than upon the complete liquidation of the company, the company would be taxed at the reduced corporate tax rate applicable to such profits (between 10%-25%).

We have been granted approved enterprise status with respect to several investment programs and chose the alternative track with respect to each of these programs. See Item 5A. "Operating and Financial Review and Prospects - Operating Results - Effective Corporate Tax Rate."

The benefits available to an approved enterprise are conditional upon the fulfillment of conditions stipulated in the Investment Law and its 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, its tax benefits could be canceled, in whole or in part, and it would be required to refund the amount of tax benefits, with the addition of the Israeli consumer price index linkage adjustment and interest.

An amendment to the Investments Law, which came into effect on April 1, 2005, changed certain provisions of such law, including the criteria for investments qualified to receive tax benefits under the Investments Law. An eligible investment program under the amendment will qualify for benefits as a "Privileged Enterprise" (rather than the previous terminology of Approved Enterprise). As a result of the amendment, a company is no longer obliged to acquire approved enterprise status in order to receive the tax benefits previously available under the alternative benefits track, and therefore there is no need to apply to the Investment Center for this purpose (however, approved enterprise status remains mandatory for companies seeking grants). Rather, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set out by the amendment. Companies may also approach the Israeli Tax Authority for a pre-ruling regarding its eligibility for benefits under the amendment. The amendment does not apply to investment programs approved prior to December 31, 2004. The new tax regime will apply only to new investment programs.

Tax benefits are available under the April 2005 amendment to production facilities (or other eligible facilities), which are generally required to derive more than 25% of their business income from export. In order to receive the tax benefits, a company must make an investment in the Privileged Enterprise exceeding a minimum amount specified in the Investment Law. Such investment 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 Privileged Enterprise, referred to as the Year of Election. Where the company requests to have the tax benefits apply to an expansion of existing facilities, only the expansion will be considered a Privileged Enterprise and the company's effective tax rate will be the result of a weighted combination of the applicable rates. In such case, the minimum investment required in order to qualify as a Privileged Enterprise is required to exceed a certain percentage of the company's production assets before the expansion.

To date, we have not utilized the benefits of the Investment Law, as amended subsequent to April 1, 2005, since we are utilizing carryforward losses from previous years for tax purposes.

In December 2010, the Israeli Parliament passed the Law for Economic Efficiency for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among other things, amendments to the Investment Law, effective as of January 1, 2011. According to the amendment, the benefit tracks under the Investment Law were modified and a uniform tax rate will apply to all of the income of an Approved or Privileged Enterprise. Companies may elect to irrevocably implement the amendment (while waiving benefits provided under the Investment Law as currently in effect) and subsequently would be subject to the amended tax rates that are: 15% in 2011 and 2012 (in development area A - 10%), 12.5% in, 2013 and 2014 (in development area A - 7%) and 12% in 2015 and thereafter (in development area A - 6%). Our company is not in development area A. Our company chose not to adopt this amendment, but may elect to do so in the future should we choose to adopt this amendment, we will have to inform the Israeli tax authority.

Tax Benefits for Research and Development

Israeli tax law allows, under specified conditions, a tax deduction for expenditures, including capital expenditures, in the year incurred relating to scientific research and development projects, if the expenditures are approved by the Office of the Chief Scientist, determined by the field of research, and the research and development is for the promotion of the company and is carried out by or on behalf of the company seeking such deduction. However, the amount of such deductible expenses shall be 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 are deductible over a three-year period.

Tax Benefits Under the Law for the Encouragement of Industry (Taxes), 1969

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

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

- right to elect, under specified conditions, to file a consolidated tax return with additional related Israeli Industrial Companies; and

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

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

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

Grants under the Law for the Encouragement of Industrial Research and Development, 1984

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

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

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

The terms of the Israeli Government participation generally requires that the products developed with such grants be manufactured in Israel and that the know-how developed under an approved research and development program may not be transferred to any third parties outside Israel. However, the Office of the Chief Scientist may approve the transfer of manufacturing rights outside Israel in exchange for an import of different manufacturing into Israel as a substitute. In addition, under certain circumstances and subject to the Office of the Chief Scientist's prior approval, know-how that has been funded by the Office of the Chief Scientist may be transferred outside of Israel, generally in the following cases: (a) the grant recipient pays to the Office of the Chief Scientist a portion of the consideration paid for such funded know-how (according to a certain formulas), (b) the grant recipient receives know-how from a third party in exchange for its funded know-how, or (c) such transfer of funded know-how arises in connection with certain types of cooperation in research and development activities. No approval is required for the sale or export of any products resulting from such research and development.

The Research Law imposes reporting requirements with respect to certain changes in the ownership of a grant recipient. The law requires the grant recipient and its controlling shareholders and interested parties to notify the Office of the Chief Scientist of any change in control of the recipient or a change in the holdings of the means of control of the recipient that results in a non-Israeli becoming an interested party directly in the recipient and requires the new interested party to undertake to the Office of the Chief Scientist to comply with the Research Law. In addition, the rules of the Office of the Chief Scientist may require prior approval of the Office of the Chief Scientist or additional information or representations in respect of certain of such events. For this purpose, "control" is defined as the ability to direct the activities of a company other than any ability arising solely from serving as an officer or director of the company. A person is presumed to have control if such person holds 50% or more of the means of control of a company. "Means of control" refers to voting rights or the right to appoint directors or the chief executive officer. An "interested party" of a company includes a holder of 5% or more of its outstanding share capital or voting rights, its chief executive officer and directors, someone who has the right to appoint its chief executive officer or at least one director, and a company with respect to which any of the foregoing interested parties owns 25% or more of the outstanding share capital or voting rights or has the right to appoint 25% or more of the directors. Accordingly, any non-Israeli who acquires 1% or more of our ordinary shares will be required to notify the Office of the Chief Scientist that it has become an interested party and to sign an undertaking to comply with the Research Law. Additionally, procedures regulated under the Research Law require the grant recipient to obtain the approval of the Office of the Chief Scientist prior to a change in the holdings of the recipient or change in the holdings of the means of control of the recipient if the recipient's shares are being issued to a non-Israeli person or entity and require the new non-Israeli party to undertake to the Office of the Chief Scientist to comply with the Research Law.

In the past, we received funding from the Office of the Chief Scientist for selected research and development projects. We did not apply for any research and development grants from the Office of the Chief Scientist during the three years ended December 31, 2013. See Item 5C. "Operating and Financial Review and Prospects - Research and Development" for additional details on the grants that we have received and our contingent liability to the Office of the Chief Scientist.

Taxation of Dividends Paid on Our Ordinary Shares

Taxation of Non-Israeli Shareholders

Under Israeli tax law, a distribution of dividends from income attributable to an Approved Enterprise and Privileged Enterprise will be subject to tax in Israel at the 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 (but the 12-year limitation does not apply to a Foreign Investors Company). Any distribution of dividends from income that is not attributable to an Approved Enterprise will be subject to tax in Israel at the rate of 25%, except that dividends distributed on or after January 1, 2006 to an individual and an entity who is deemed “a non-substantial shareholder” will be subject to tax at the rate of 20%.

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 is 25%. Dividends received by a U.S. company that holds at least 10% of our voting rights will be subject to withholding tax at the rate of 12.5%, provided certain other conditions in the tax treaty are met (or at the tax rate of 15% in respect of dividends paid from income attributable to our Approved Enterprises and Privileged Enterprises).

Taxation of Israeli Shareholders

Israeli resident individuals are generally subject to Israeli income tax on the receipt of dividends paid on our ordinary shares, other than bonus shares (share dividends) or stock dividends, at the rate of 25%, or 30% for a shareholder that is considered a material shareholder (within the meaning of the Israeli Income Tax Ordinance) at any time during the 12-month period preceding such distribution. Dividends paid on our ordinary shares to Israeli companies are exempt from such tax, except for dividends distributed from income derived outside of Israel, which are subject to the 25% tax rate.

Dividends paid from income derived from attributable to an Approved Enterprise and Privileged Enterprise are subject to tax, which is withheld at the source, at the rate of 15%. We cannot assure you that we will designate the profits that are being distributed in a way that will reduce shareholders' tax liability to this tax rate.

Taxation of Capital Gains

Taxation of Israeli Shareholders

Israeli law generally imposes a capital gains tax on the sale of any capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of assets located in Israel, including shares in Israeli companies, by both residents and non-residents of Israel, unless a specific exemption is available or unless a tax treaty between Israel and the shareholder's country of residence provides otherwise. The law distinguishes between real gain and 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 or, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

As of January 1, 2006, the tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 20% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 25%. Additionally, if such shareholder is considered a "material shareholder" at any time during the 12-month period preceding such sale, i.e., such shareholder holds directly or indirectly, including with others, at least 10% of any means of control in the company, the tax rate shall be 25%. Israeli companies are subject to the corporate tax rate on capital gains derived from the sale of shares, unless such companies were not subject to the Adjustments Law (or certain regulations) at the time of publication of the aforementioned amendment to the Tax Ordinance that came into effect on January 1, 2006, in which case the applicable tax rate is 25%. However, the foregoing tax rates do not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (which shares may be subject to a different tax arrangement).

The tax basis of shares acquired prior to January 1, 2003 will be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a request may be made to the tax authorities to consider the actual adjusted cost of the shares as the tax basis if it is higher than such average price.

Taxation of Non-Israeli Shareholders

Capital gains from the sale of our ordinary shares by non-Israeli shareholders are exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock exchange or regulated market outside of Israel, provided however that such capital gains are not derived from a permanent establishment in Israel, such shareholders are not subject to the Adjustments Law, and such shareholders did not acquire their shares prior to an initial public offering. 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 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.

Pursuant to the treaty between the government of the United States of America and the government of Israel with respect to taxes on income, as amended, or the U.S.-Israel Tax Treaty, the sale, exchange or disposition of ordinary shares by a person who (i) holds the ordinary shares as a capital asset, (ii) qualifies as a resident of the United States within the meaning of the U.S.-Israel Tax Treaty and (iii) is entitled to claim the benefits afforded to such person by the U.S.-Israel Tax Treaty, or Treaty U.S. Resident, generally, will not be subject to the Israeli capital gains tax. Such exemption will not apply if (i) the Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions, or (ii) the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel. In such case, the sale, exchange or disposition of ordinary shares would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel Tax Treaty does not relate to U.S. state or local taxes.

Foreign Exchange Regulations

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

Israeli Transfer Pricing Regulations

The Income Tax Regulations (Determination of Market Terms), November 2006, promulgated under Section 85A of the Tax Ordinance, generally require that all cross-border transactions carried out between related parties be conducted on an arm’s length basis and be taxed accordingly.

United States Federal Income Taxation

The following is a description of the material U.S. federal income tax consequences of the acquisition, ownership and disposition of our ordinary shares. This description addresses only the U.S. federal income tax considerations that are relevant to U.S. Holders (as defined below) who hold our ordinary shares as capital assets. This summary is based on the U.S. Internal Revenue Code of 1986, as amended, or the Code, Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, or the Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. There can be no assurance that the U.S. Internal Revenue Service, or the IRS, will not take a different position concerning the tax consequences of the acquisition, ownership and disposition of our ordinary shares or that such a position would not be sustained. This description does not address all tax considerations that may be relevant with respect to an investment in our ordinary shares. This description does not account for the specific circumstances of any particular investor, such as:

- broker-dealers,
- financial institutions,
- certain insurance companies,

- investors liable for alternative minimum tax,
- tax-exempt organizations,

- non-resident aliens of the United States or taxpayers whose functional currency is not the U.S. dollar,
- persons who hold the ordinary shares through partnerships or other pass-through entities,
- persons who acquire their ordinary shares through the exercise or cancellation of employee stock options or otherwise as compensation for services,
- investors that actually or constructively own 10% or more of our shares by vote or value, and
- investors holding ordinary shares as part of a straddle, or appreciated financial position or a hedging or conversion transaction.

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

This summary does not address the effect of any U.S. federal taxation other than U.S. federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation. You are urged to consult your tax advisors regarding the foreign and U.S. federal, state and local tax consequences of an investment in ordinary shares.

For purposes of this summary, a U.S. Holder is:

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

Taxation of Distributions

Subject to the discussion, below, under the heading "—Passive Foreign Investment Companies," the gross amount of any distributions received with respect to our ordinary shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. federal income tax purposes to the extent of our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. Because we do not expect to maintain calculations of our earnings and profits under U.S. federal income tax principles, it is expected that the entire amount of any distribution will generally be reported as dividend income to you. Dividends are included in gross income as

ordinary income. Distributions in excess of our current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of your tax basis in our ordinary shares and any amount in excess of your tax basis will be treated as gain from the sale of ordinary shares. See "—Disposition of Ordinary Shares" below for a discussion of the taxation of capital gains. Our dividends will not qualify for the dividends-received deduction generally available to corporations under section 243 of the Code.

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

Subject to complex limitations, some of which vary depending upon the U.S. Holder's circumstances, any Israeli withholding tax imposed on dividends paid with respect to our ordinary shares will be a foreign income tax eligible for credit against a U.S. Holder's U.S. federal income tax liability (or, alternatively, for deduction against income in determining such tax liability). The limitation on foreign income taxes eligible for credit is calculated separately with respect to specific classes of income. Dividends generally will be treated as foreign-source passive category income or, in the case of certain U.S. Holders, general category income for U.S. foreign tax credit purposes. Further, there are special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to a reduced tax rate (see discussion below). A U.S. Holder may be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on our ordinary shares if such U.S. Holder fails to satisfy certain minimum holding period requirements or to the extent such holder's position in ordinary shares is hedged. The rules relating to the determination of the foreign tax credit are complex, and you should consult with your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

Subject to certain limitations, "qualified dividend income" received by a non-corporate U.S. Holder will be subject to tax at the lower long-term capital gain rates. Distributions taxable as dividends paid on our ordinary shares should qualify for a reduced rate provided that either: (i) we are entitled to benefits under the Treaty or (ii) our ordinary shares are readily tradable on an established securities market in the United States and certain other requirements are met. We believe that we are entitled to benefits under the Treaty and that our ordinary shares currently are readily tradable on an established securities market in the United States. However, no assurance can be given that our ordinary shares will remain readily tradable. The rate reduction does not apply unless certain holding period requirements are satisfied, nor does it apply to dividends received from a passive foreign investment company (see discussion below) or in respect of certain risk-reduction transactions or in certain other situations. The legislation enacting the reduced tax rate on qualified dividend income contains special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject to the reduced tax rate. U.S. Holders of our ordinary shares should consult their own tax advisors regarding the effect of these rules in their particular circumstances.

Disposition of Ordinary Shares

If you sell or otherwise dispose of our ordinary shares, you will generally recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and your adjusted tax basis in our ordinary shares, in each case determined in U.S. dollars. Such gain or loss will generally be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. Long-term capital gain realized by a non-corporate U.S. Holder is generally eligible for a preferential tax rate. In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

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

An accrual basis U.S. Holder may elect the same treatment required of cash basis taxpayers with respect to a sale or disposition of our ordinary shares that are traded on an established securities market, provided that the election is applied consistently from year to year. Such election may not be changed without the consent of the IRS. In the event that an accrual basis U.S. Holder does not elect to be treated as a cash basis taxpayer (pursuant to the Treasury regulations applicable to foreign currency transactions), such U.S. Holder may have a foreign currency gain or loss for

U.S. federal income tax purposes because of differences between the U.S. dollar value of the currency received prevailing on the trade date and the settlement date. Any such currency gain or loss would be treated as ordinary income or loss and would be in addition to the gain or loss, if any, recognized by such U.S. Holder on the sale or disposition of such ordinary shares.

Any foreign currency gain or loss a U.S. Holder realizes will be U.S. source ordinary income or loss.

Passive Foreign Investment Companies

If we were to be classified as a ‘‘passive foreign investment company’’, or a PFIC, in any taxable year, a U.S. Holder would be subject to special rules generally intended to reduce or eliminate any benefits from the deferral of U.S. federal income tax that a U.S. Holder could otherwise derive from investing in a non-U.S. company that does not distribute all of its earnings on a current basis. We will be considered a PFIC, for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, passive income generally includes dividends, interest, royalties, rents, annuities and the excess of gains over losses from the disposition of assets that produce passive income. Included in the calculation of our income and assets is our proportionate share of the income and assets of each corporation in which we own, directly or indirectly, at least a 25% interest, by value. If we were determined to be a PFIC for U.S. federal income tax purposes, unfavorable and highly complex rules would apply to U.S. Holders owning ordinary shares directly or indirectly. Accordingly, you are urged to consult your tax advisors regarding the application of such rules.

As a result of our relatively substantial cash position at this time, we believe that we may be classified as a PFIC in 2013 and future years, including 2014, under a literal application of the asset test described above, which looks solely to the market value of our assets. Furthermore, in determining the average quarterly value of our gross assets, the aggregate value of our assets will generally be deemed to be equal to the sum of the aggregate value of our outstanding shares (our “market capitalization”) plus our liabilities. We intend to take the position that the excess of our market capitalization plus liabilities over the book value of our assets may generally be treated as non-passive assets to the extent of our non-passive activities. Accordingly, if we are not now a PFIC, we may become a PFIC if our market capitalization were to decrease significantly while we still hold substantial cash.

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

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

- the amount allocated to the current taxable year, and to any taxable years in your holding period prior to the first day in which we were treated as a PFIC will be treated as ordinary income, and

- the amount allocated to each prior taxable year during which we are considered a PFIC would be subject to tax at the highest individual or corporate tax rate, as the case may be, and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year.

If we were a PFIC for any taxable year during which a U.S. Holder holds our ordinary shares and any of our non-U.S. subsidiaries is also a PFIC, such U.S. Holder would generally be treated as owning a proportionate amount (by value) of the underlying shares of each such non-U.S. subsidiary classified as a PFIC for purposes of the application of these rules. U.S. Holders are urged to consult their tax advisers regarding the application of the PFIC rules to any of our subsidiaries.

If you make either a timely QEF election or a timely mark-to-market election in respect of your ordinary shares, you would not be subject to the rules described above. You would not be eligible to make a QEF election unless we comply with certain information reporting requirements. We do not intend to provide the information necessary for U.S. Holders to make QEF elections.

If we are a PFIC for any taxable year during which a U.S. Holder holds our ordinary shares, then in lieu of being subject to the tax and interest charge rules discussed above, a U.S. Holder may make an election to include gain on the stock of a PFIC as ordinary income under a mark-to-market method, provided that such ordinary shares are "regularly traded" on a "qualified exchange." In general, our ordinary shares will be treated such as "regularly traded" for a given calendar year if more than a de minimis quantity of our ordinary shares is traded on a qualified exchange on at least 15 days during each calendar quarter of such calendar year. Our ordinary shares are listed on the Tel Aviv Stock Exchange and the NASDAQ. However, no assurance can be given that our ordinary shares will be regularly traded for purposes of the mark-to-market election. In addition, because a mark-to-market election cannot be made for any lower-tier PFICs that we may own, a U.S. Holder may continue to be subject to the PFIC rules with respect to such holder's indirect interest in any investments held by us that are treated as an equity interest in a PFIC for U.S. federal income tax purposes.

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

If a U.S. Holder owns our ordinary shares during any year in which we are a PFIC, the U.S. Holder generally must file an IRS Form 8621 with respect to the company, generally with the U.S. Holder's federal income tax return for that year. U.S. Holders should consult their tax advisers regarding whether we are a PFIC and the potential application of the PFIC rules.

Additional Tax on Investment Income

In addition to the income taxes described above, U.S. Holders that are individuals, estates or trusts and whose income exceeds certain thresholds will be subject to a 3.8% Medicare contribution tax on net investment income, which includes dividends and capital gains.

Backup Withholding and Information Reporting

Payments in respect of our ordinary shares may be subject to information reporting to the IRS and to U.S. backup withholding tax at the rate (currently) of 28%. Backup withholding will not apply, however, if you (i) are a corporation or fall within certain exempt categories, and demonstrate the fact when so required, or (ii) furnish a correct taxpayer identification number and make any other required certification.

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

U.S. individuals that hold certain specified foreign financial assets, including stock in a foreign corporation, with values in excess of certain thresholds are required to file with their U.S. federal income tax return Form 8938, on which information about the assets, including their value, is provided. Taxpayers who fail to file the form when required are subject to penalties. An exemption from reporting applies to foreign assets held through a financial institution. Investors are encouraged to consult with their own tax advisors regarding the possible application of this disclosure requirement to their investment in our ordinary shares.

The above description is not intended to constitute a complete analysis of all tax consequences relating to acquisition, ownership and disposition of our ordinary shares. You should consult your tax advisor concerning the tax consequences of your particular situation.

F. Dividend and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We are subject to certain of the reporting requirements of the Exchange Act, as applicable to "foreign private issuers" as defined in Rule 3b-4 under the Exchange Act. As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, and transactions in our equity securities by our officers and directors are exempt from reporting and the "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act. However, we file with the SEC an annual report on Form 20-F containing financial statements audited by an independent accounting firm. We also submit to the SEC reports on Form 6-K containing (among other things) press releases and unaudited financial information. We post our annual report on Form 20-F on our website (www.mtsint.com) promptly following the filing of our annual report with the SEC. The information on our website is not incorporated by reference into this annual report.

This annual report and the exhibits thereto and any other document we file pursuant to the Exchange Act may be inspected without charge and copied at prescribed rates at the SEC public reference room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the SEC's public reference room in Washington, D.C. by calling the SEC at 1-800-SEC-0330. The Exchange Act file number for our SEC filings is 0-28950.

The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the SEC using its EDGAR (Electronic Data Gathering, Analysis, and Retrieval) system.

The documents concerning our company that are referred to in this annual report may also be inspected at our offices located at 14 Hatidhar Street, Ra'anana 4366516, Israel.

I. Subsidiary Information

Not applicable.

ITEMQUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS
11.

Exposure to Market Risks

We may be exposed to a variety of risks, including changes in interest rates affecting primarily interest received on short-term deposits and foreign currency fluctuations. In 2013, our principal market risk was our exposure to currency exchange fluctuations. We attempt to limit our exposure to currency exchange rate risk by using various hedging techniques, including forward and option contracts. However, we cannot eliminate the effects of currency fluctuations altogether. Exchange rate fluctuations resulting in a devaluation of the U.S. dollar compared to the NIS could have a material adverse impact on our operating results and share price.

Foreign Currency Exchange Risk

We carry out transactions involving foreign currency exchange derivative financial instruments. The transactions are designed to hedge our exposure in NIS against the U.S. dollar. We recognize derivative instruments as either assets or liabilities and measure those instruments at fair value in accordance with FASB ASC 815. If a derivative meets the

definition of a cash flow hedge and is so designated, changes in the fair value of the derivative are recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative designated as a hedge is recognized in earnings. If a derivative does not meet the definition of a hedge, the changes in the fair value are included in earnings. Our call and put option contracts do not qualify as hedging instruments under ASC 815 “Derivatives and Hedging,” as amended.

As of December 31, 2013, we had outstanding call and put option contracts in the amount of $0.9 million. These contracts are for periods of up to seven months. Our accumulated other comprehensive income as of such date does not include any unrealized gain on the call and put option contracts. In 2013, we entered into forward, call and put option contracts, in the amount of $2.4 million that converted a portion of our floating currency liabilities to a fixed rate basis, thus reducing the impact of the currency changes on our cash flows. The purpose of our foreign currency hedging activities is to protect the Company from risk that the eventual dollar cash flows from international activities will be adversely affected by changes in the exchange rates. Changes in the fair value of put option contracts are reflected in our consolidated statements of operations as financial income or expense. In 2013, we recorded financial income of approximately $65,000 with respect to the above transactions in our consolidated statements of operations.

We have operations in several countries in connection with the sale of our products. A substantial portion of our sales and expenditures are denominated in dollars. We have mitigated, and expect to continue to mitigate, a portion of our foreign currency exposure through salaries, marketing and support operations in which all costs are local currency based. As a result, our results of operations and cash flows can be affected by fluctuations in foreign currency exchange rates (primarily the Euro and NIS). A hypothetical 10% movement in foreign currency rates (primarily the Euro and NIS) against the dollar, with all other variables held constant on the expected sales, would result in a decrease or increase in expected 2014 sales revenues of approximately $120,000 and on the other hand a decrease or increase in expected 2014 expenses of approximately $300,000.

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

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

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

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transaction and dispositions of the assets of the company;

- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. 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.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on that assessment, our management concluded that as of December 31, 2013, our internal control over financial reporting was effective.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Yaacov Goldman, an independent director, meets the definition of an audit committee financial expert, as defined by rules of the SEC.

ITEM 16B. CODE OF ETHICS

We have adopted a code of ethics that applies to our chief executive officer and all senior financial officers of our company, including the chief financial officer, chief accounting officer or controller, or persons performing similar functions. Our code of ethics has been filed as an exhibit to this annual report. Written copies are available upon request. If we make any substantive amendment to the code of ethics or grant any waivers, including any implicit waiver, from a provision of the codes of ethics, we will disclose the nature of such amendment or waiver on our website.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Independent Registered Public Accounting Firm Fees

The following table sets forth, for each of the years indicated, the billed fees by our principal independent registered public accounting firm. All of such fees were pre-approved in advance by our audit committee.

	Year Ended December 31,	
Services Rendered	2012	2013
Audit (1)	$ 91,000	$ 97,025
Audit Related	$ 0	$ 0
Tax	$ 0	$ 0
Other Services (2)	$ 0	$ 25,000

(1) Audit fees relate to audit services provided for each of the years shown in the table, including fees associated with the annual audit and reviews of our interim financial results, consultations on various accounting issues and audit services provided in connection with other statutory or regulatory filings.

(2) Other services relate to due diligence services provided with respect to a proposed transaction.

Pre-Approval Policies and Procedures

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

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

Not applicable.

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

Issuer Purchase of Equity Securities

Neither we nor any affiliated purchaser has purchased any of our ordinary shares during 2013.

ITEM 16F. CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANT

None.

ITEM 16G. CORPORATE GOVERNANCE

Under NASDAQ Stock Market Rule 5615(a)(3), foreign private issuers, such as our company, are permitted to follow certain home country corporate governance practices instead of certain provisions of the NASDAQ Stock Market Rules. A foreign private issuer that elects to follow a home country practice instead of any of such NASDAQ rules 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. We have provided NASDAQ with notices of non-compliance with respect to the following NASDAQ rules:

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

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

- The requirement to obtain shareholder approval for the establishment or amendment of certain equity based compensation plans, an issuance that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the

stock or assets of another company. Under Israeli law and practice, the approval of the board of directors is required for the establishment or amendment of equity based compensation plans and private placements. Under Israeli regulations, Israeli companies whose shares have been publicly offered only outside of Israel or are listed for trade only on an exchange outside of Israel, such as our company, are exempt from the Israeli law requirement to obtain shareholder approval for private placements of a 20% or more interest in the company. For the approvals and procedures required under Israeli law and practice for an issuance that will result in a change of control of the company and acquisitions of the stock or assets of another company, see Item 6.C. “Directors, Senior Management and Employee - Board Practices - Approval of Related Party Transactions Under Israeli Law-Disclosure of Personal Interests of a Controlling Shareholder; Approval of Transactions with Controlling Shareholders” and Item 10.B. “Additional Information -- Memorandum and Articles of Association - Provisions Restricting Change in Control of Our Company.”

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

No applicable.

ITEM 18. FINANCIAL STATEMENTS

Consolidated Financial Statements

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ITEM 19. EXHIBITS

Exhibit	Description
1.1	Memorandum of Association of the Registrant (1)
1.2	Articles of Association of the Registrant (1)
1.3	Amendment to Articles of Association of the Registrant (2)
2.1	Specimen of Ordinary Share Certificate (1)
4.1	2003 Israeli Share Option Plan (3)

4.2	2006 Stock Option Plan (4)
8.1	List of Subsidiaries of the Registrant
11.1	Code of Ethics (3)
12.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended

12.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended.

13.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

13.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

15.1 Consent of Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global

101.INS* XBRL Instance Document

101.SCH* XBRL Taxonomy Extension Schema Document

101.CAL* XBRL Taxonomy Calculation Linkbase Document

101.DEF* XBRL Taxonomy Extension Definition Linkbase Document

101.LAB* XBRL Taxonomy Label Linkbase Document

101.PRE* XBRL Taxonomy Label Linkbase Document

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* Pursuant to Rule 406T of Regulation S-T, these interactive data files 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 the purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

(1) Filed as an exhibit to the Registrant's Registration Statement on Form F-1, registration number 333-05814, filed with the Securities and Exchange Commission, and incorporated herein by reference.

(2) Filed as Exhibit 1.3 to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2009, and incorporated herein by reference.

(3) Filed as an Exhibit to the Registrant's Annual Report on Form 20-F for the year ended December 31, 2003, and incorporated herein by reference.

(4) Filed as Appendix B to Item 1 of the Registrant's Report on Form 6-K for the month of June 2006 submitted on June 23, 2006, and incorporated herein by reference.

MER TELEMANAGEMENT SOLUTIONS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2013

U.S. DOLLARS IN THOUSANDS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

MER TELEMANAGEMENT SOLUTIONS LTD.

We have audited the accompanying consolidated balance sheets of Mer Telemanagement Solutions Ltd. ("the Company") and its subsidiaries as of December 31, 2012 and 2013, and the related consolidated statements of operations, statements of comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2012 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States.

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

Tel-Aviv, Israel
March 12, 2014

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2012	2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$4,190	$6,369
Restricted cash	38	63
Marketable securities (Note 3)	139	153
Trade receivables (net of allowance for doubtful accounts of $ 46 at December 31, 2012 and 2013, respectively)	1,066	943
Deferred income taxes (Note 9d)	371	-
Other accounts receivable and prepaid expenses (Note 4)	175	147
Total current assets	5,979	7,675
LONG-TERM ASSETS:		
Lease deposits	4	-
Severance pay fund	658	725
Total long-term assets	662	725
PROPERTY AND EQUIPMENT, NET (Note 5)	245	183
OTHER ASSETS:		
Intangible assets, net (Note 6a)	759	567
Goodwill	3,479	3,479
Total other assets	4,238	4,046
Total assets	$11,124	$12,629

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2012	2013
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 279	$ 254
Accrued expenses and other liabilities (Note 7)	2,393	2,200
Deferred revenues	1,648	1,766
Liabilities of discontinued operations (Note 1a)	435	362
Total current liabilities	4,755	4,582
LONG-TERM LIABILITIES:		
Accrued severance pay	800	857
Deferred tax liability	-	29
COMMITMENTS AND CONTINGENT LIABILITIES (Note 8)		
SHAREHOLDERS' EQUITY (Note 11):		
Share capital -		
Ordinary shares of NIS 0.01 par value - Authorized: 12,000,000 shares at December 31, 2012 and 2013; Issued: 4,625,707 at December 31, 2012 and 4,670,957 at December 31, 2013; Outstanding: 4,620,307 shares at December 31, 2012 and 4,665,557 at December 31, 2013	13	13
Additional paid-in capital	20,120	20,317
Treasury shares (5,400 Ordinary shares at December 31, 2012 and 2013)	(29)	(29)
Accumulated other comprehensive loss	5	(6)
Accumulated deficit	(14,540)	(13,134)
Total shareholders' equity	5,569	7,161
Total liabilities and shareholders' equity	$ 11,124	$ 12,629

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year ended December 31,		
	2011	2012	2013
Revenues (Note 12):			
Product sales	$3,828	$3,665	$2,076
Services	8,175	9,461	10,396
Total revenues	12,003	13,126	12,472
Cost of revenues:			
Product sales	1,105	1,154	770
Services	2,836	3,340	3,254
Total cost of revenues	3,941	4,494	4,024
Gross profit	8,062	8,632	8,448
Operating expenses:			
Research and development, net	1,909	1,329	1,389
Selling and marketing	1,905	2,457	2,164
General and administrative	3,847	2,804	3,188
Total operating expenses	7,661	6,590	6,741
Operating income	401	2,042	1,707
Financial income, net	2	60	61
Capital gain on sale of investment in affiliate	78	-	-
Income before taxes on income	481	2,102	1,768
Taxes on income, net (Note 9)	10	736	435
Net income from continuing operations	471	1,366	1,333
Net income (loss) from discontinued operations	(84)	-	73
Net income	$387	$1,366	1,406
Net earnings per share:			
Basic and diluted net earnings per Ordinary share from continuing operations	$0.11	$0.30	$0.28
Basic and diluted net earnings (loss) per Ordinary share from discontinued operations	$(0.02)	$-	$0.02
Basic and diluted net income per share	$0.09	$0.30	$0.30
	4,459,057	4,478,677	4,659,230

Weighted average number of Ordinary shares used in computing basic net earnings per share			
Weighted average number of Ordinary shares used in computing diluted net earnings per share	4,459,057	4,531,384	4,720,966

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

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

	Year ended December 31,		
	2011	2012	2013
Net income	$387	$1,366	$1,406
Other comprehensive income (loss):			
Change in foreign currency translation adjustments	16	10	(29)
Available-for-sale investments:			
Change in net unrealized gains (losses)	(29)	8	19
Reclassification adjustment for net (gains) loss included in net loss	(2)	6	(1)
Other comprehensive income (loss)	(15)	24	(11)
Comprehensive income	$372	$1,390	$1,395

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Share capital		Additional paid-in	Treasury	Accumulated other comprehensive income	Accumulated	Total shareholders'
	Number	Amount	capital	shares	(loss)	deficit	equity
Balance as of January 1, 2011	4,459,057	$ 13	$ 19,676	$ (29)	$ (4)	$ (16,293)	$ 3,363
Stock-based compensation related to options issued to employees	-	-	65	-	-	-	65
Stock-based compensation related to options issued to non employees			2				2
Transaction with principal shareholder	-	-	30	-	-	-	30
Other comprehensive income (loss):							
Unrealized losses of available-for-sale marketable securities, net	-	-	-	-	(31)	-	(31)
Foreign currency translation adjustments					16		16
Net income	-	-	-	-	-	387	387
Balance as of December 31, 2011	4,459,057	13	19,773	(29)	(19)	(15,906)	3,832
Stock-based compensation related to options issued to employees	-	-	41	-	-	-	41
Stock-based compensation related to options issued to non employees	-	-	3	-	-	-	3
	161,250	*) -	303	-	-	-	303

Exercise of stock options							
Other comprehensive income (loss):							
Unrealized gains of available-for-sale marketable securities, net	-	-	-	-	14	-	14
Foreign currency translation adjustments	-	-	-	-	10	-	10
Net income	-	-	-	--	-	1,366	1,366
Balance as of December 31, 2012	4,620,307	13	20,120	(29)	5	(14,540)	5,569

*) Represents an amount lower than $ 1.

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

Cont.	Share capital Number	Share capital Amount	Additional paid-in capital	Treasury shares	Accumulated other comprehensive income (loss)	Accumulated deficit	Total shareholders' equity
Balance as of December 31, 2012	4,620,307	$ 13	$ 20,120	$ (29)	$ 5	$ (14,540)	$ 5,569
Stock-based compensation related to options issued to employees	-	-	93	-	-	-	93
Stock-based compensation related to options issued to non employees	-	-	14	-	-	-	14
Exercise of stock options	45,250	*)	90	-	-	-	90
Other comprehensive income (loss):							
Unrealized gains of available-for-sale marketable securities, net	-	-	-	-	18	-	18
Foreign currency translation adjustments	-	-	-	-	(29)	-	(29)
Net income	-	-	-	-	-	1,406	1,406
Balance as of December 31, 2013	4,665,557	$ 13	$ 20,317	$ (29)	$ (6)	$ (13,134)	$ 7,161
Accumulated foreign currency translation adjustments as of December 31, 2013					$ (24)		
Accumulated unrealized gains of available-for-sale marketable securities, net as of December 31, 2013					18		

(6)

*) Represents an amount lower than $ 1.

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	Year ended December 31,		
	2011	2012	2013
Cash flows from operating activities:			
Net income	$ 387	$ 1,366	$ 1,406
Net loss from discontinued operations	84	-	(73)
Net income from continuing operations	471	1,366	1,333
Adjustments required to reconcile net income from continuing operations to net cash provided by operating activities:			
Loss (gains) on sale of available-for-sale marketable securities	(2)	6	(1)
Capital gain on sale of investment	(78)	-	-
Depreciation and amortization	447	393	316
Deferred income taxes, net	2	(340)	400
Employees and non-employees stock-based compensation	67	44	107
Transaction with principal shareholder	30	-	-
Accrued severance pay, net	(110)	(1)	(10)
Decrease (increase) in trade receivables, net	397	(212)	123
Decrease (increase) in other accounts receivable and prepaid expenses	76	(178)	30
Change in lease deposits	24	2	3
Increase (decrease) in trade payables	21	(47)	(25)
Increase (decrease) in accrued expenses and other liabilities	269	144	(222)
Decrease in deferred revenues	(427)	(377)	118
Increase (decrease) in restricted cash	(45)	7	(25)
Net cash provided by operating activities from continuing operations	1,142	807	2,147
Cash flows from investing activities:			
Proceeds from sale of affiliate	90	-	-
Purchase of property and equipment	(87)	(188)	(62)
Proceeds from sale of property and equipment	9	2	-
	(49)	(74)	(80)

Investment in available-for-sale marketable securities			
Proceeds from sale of available-for-sale marketable securities	40	71	84
Net cash provided by (used in) investing activities	3	(189)	(58)

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	Year ended December 31,		
	2011	2012	2013
Cash flows from financing activities:			
Proceeds from exercise of stock options	-	303	90
Net cash provided by financing activities	-	303	90
Net cash provided from discontinued Operations	-	-	-
Increase in cash and cash equivalents	1,145	921	2,179
Cash and cash equivalents at the beginning of the year	2,124	3,269	4,190
Cash and cash equivalents at the end of the year	$3,269	$4,190	$6,369
Supplemental disclosure of cash flows activities:			
Cash paid during the year for:			
Income taxes	$8	$1,210	$274

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

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL

a. Mer Telemanagement Solutions Ltd. ("the Company" or "MTS") was incorporated on December 27, 1995. MTS and its subsidiaries ("the Group") is a worldwide provider of Telecom Expense Management (TEM), Mobile Virtual Network Enabler and Mobile Money services and solutions.

The Company's wholly-owned subsidiaries in the United States and Hong Kong, namely, MTS IntegraTRAK Inc. and MTS Asia Ltd., respectively, act as marketing and customer service organizations in those countries.

In March 2009, the Company discontinued the operations of TABS Brazil Ltda. its wholly owned subsidiary in Brazil, and its results of operations were classified as discontinued operations in the statement of operations. There are no assets from discontinued operations as of December 31, 2012 and 2013.

The summarized results of operations for TABS Brazil Ltda. for the years ended December 31, 2011, 2012 and 2013, which were reported separately as discontinued operations in the consolidated statements of income, are as follows:

	Year ended December 31,		
	2011	2012	2013
Total operating expenses (income)	$ 84	$ -	$ (73)
Operating (loss) income	(84)	-	73
Net (loss) income from discontinued operations	(84)	-	73
Basic and diluted net income (loss) per Ordinary share from discontinued operations	$ (0.02)	-	$ 0.02

b. MTS's products are designed to provide telecommunication and information technology managers with tools to reduce communication costs, recover charges payable by third parties, and to detect and prevent abuse and misuse of telephone networks including fault telecommunication usage. MTS is a global provider of services and solutions in the Telecom Expense Management (TEM), Cloud Billing, Mobile Virtual Network Enabler (MVNE) and Mobile Money markets. The Company’s TEM Suite helps organizations reduce operational expenses, improve productivity and optimize networks and services associated with communications networks and information technology. MVNE and Mobile Money offerings enable MVNOs and financial service providers to manage their customers’ and resellers’ lifecycles.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1:- GENERAL (Cont.)

The Company's shares are listed for trade on the NASDAQ Capital Market under the symbol "MTSL".

Revenues from a major customer accounted for 16%, 23% and 33% of total revenues for the years ended December 31, 2011, 2012 and 2013, respectively.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles 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, judgments and assumptions used are reasonable based upon information available at the time they were made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

The majority of the revenues of the Group are generated in or linked to the U.S. dollar ("dollar"). In addition, a substantial portion of the Group’s costs are incurred 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 the dollar.

Accordingly, monetary accounts maintained in currencies other than the dollar are re-measured into dollars in accordance with ASC 830, "Foreign Currency Matters." All transaction gains and losses of the re-measurement of monetary balance sheet items are reflected in the consolidated statements of operations as financial income or expenses, as appropriate.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

c. Principles of consolidation:

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

d. Cash equivalents:

The Company considers all short-term highly liquid investments that are readily convertible to cash with original maturities of three months or less to be cash equivalents.

e. Restricted cash:

Restricted cash is a deposit account which is used only for payments of the Company's customers.

f. Marketable securities:

The Company accounts for investments in debt and equity securities (other than those accounted for under the equity method of accounting) in accordance with ASC 320, "Investments - Debt and Equity Securities" ("ASC 320").

Management determines the classification of investments in marketable debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date. The Company classifies all of its securities as available for sale carried at fair market value. Fair value is determined based on observable market value quotes. Available for sale securities are carried at fair value, with unrealized gains and losses reported in "accumulated other comprehensive income (loss)" in shareholders' equity. Realized gains and losses on sales of investments, are included in earnings and are derived using the specific identification method for determining the cost of securities (see also Note 3).

Interest and dividends on securities are included in financial income, net.

ASC 320 provides guidance for determining when an investment in equity securities is considered impaired, whether impairment is other-than-temporary, and for measurement of an impairment loss. An investment is considered impaired if the fair value of the investment is less than its cost. If, after consideration of all available evidence to evaluate the realizable value of its investment, impairment is determined to be other-than-temporary, then an impairment loss should be recognized equal to the difference between the investment's cost and its fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company applies ASC 320-10-65-1, "Recognition and Presentation of Other-Than-Temporary Impairments", according to which other-than-temporary impairment loss is recognized in earnings if the entity has the intent to sell the debt security, or if it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, if an entity does not expect to sell a debt security, it still needs to evaluate expected cash flows to be received and determines if a credit loss exists. In the event of a credit loss, only the amount of impairment associated with the credit loss is recognized currently in earnings. Amounts relating to factors other than credit losses are recorded in other comprehensive income (loss).

The marketable securities held by the Company are pledged to secure future rent payments for the Company's facilities in Israel.

g. Property and equipment:

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

	%
Computers and peripheral equipment	33
Office furniture and equipment	6 - 20 (mainly 7%)
Leasehold improvements	Shorter of useful life or lease term

h. Impairment of long-lived assets:

The Company's long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with ASC 360, "Property, Plant and Equipment" ("ASC 360"), 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 to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2012 and 2013, no impairment losses were identified.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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,"Intangibles-Goodwill and Other" goodwill is subject to an annual impairment test or more frequently if impairment indicators are present. Goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. The Company operates in two reporting units: Enterprise and Service providers. As determined in previous years all goodwill balance is assigned to the Enterprise reporting unit.

In September 2011, the FASB issued ASU 2011-08 which amends the rules for testing goodwill for impairment. Under the new rules, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary.

The Company engaged a third party specialist in order to perform the 2013 annual impairment test.

The Company performs its annual impairment tests during the fourth quarter of each year.

For the period from September 30, 2013 until December 31, 2013, no events occurred or circumstances changed that reduced the fair value of the reporting unit below its carrying value. During 2011, 2012 and 2013, no impairment losses were identified.

j. Intangible assets:

Intangible assets are amortized over their useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up in accordance with ASC 350. The Company's identifiable intangibles are reviewed for impairment in accordance with ASC 360 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 to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

The Company's intangible assets were all acquired in connection with historical acquisitions.

Developed technology is amortized over a period of four-to-eight years, customer relationships are amortized over a period of six to eight years and brand names are amortized over a period of eleven years. During 2011, 2012 and 2013, no impairment losses were identified.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Severance pay:

The Company's liability for severance pay for employees located in Israel 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 severance pay liability for all of its employees 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 may be withdrawn only upon the fulfillment of the obligation pursuant to Israel's Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies, and includes immaterial profits.

Severance expense for the years ended December 31, 2011, 2012 and 2013 amounted to approximately $ 155, $ 165 and $ 160, respectively.

l. Revenue recognition:

The Company generates revenues mainly from licensing the rights to use its software products and from providing maintenance, hosting and managed services, support and training. Certain software licenses require significant customization. The Company sells its products directly to end-users and indirectly through resellers and OEMs (who are considered end users).

Revenues from software license agreements are recognized when all criteria outlined in ASC 985-605, "Revenue Recognition -Software", are met. Revenue from license fees is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable and collectability is probable. The Company does not grant a right of return to its customers.

Where software arrangements involve multiple elements, revenue is allocated to each undelivered element based on vendor specific objective evidence ("VSOE") of the fair values of each undelivered element in the arrangement, in accordance with the "residual method".

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered element and is recognized as revenue when all revenue recognition criteria of ASC 985-605, as amended, are satisfied. Under the residual method, any discount in the arrangement is allocated to the delivered element. If sufficient specific objective evidence does not exist for all undelivered elements, revenue is deferred for the entire arrangement until all revenue recognition criteria are met for such undelivered elements.

The Company has immaterial number of multiple element arrangements, therefore no VSOE is established.

Revenues from maintenance and support services are recognized over the term of the maintenance and support agreement on a straight line basis.

Revenues for hosting and managed services are recognized based on SAB 104 and ASC 605-25, when delivery has occurred or services have been rendered, the fee is fixed and determinable, collectability is probable and persuasive evidence of an arrangement exists. These revenues are recognized as one unit of accounting, on a straight-line basis over the term of the last undelivered element.

Deferred revenues include unearned amounts received under maintenance and support contracts, not yet recognized as revenues.

m. Research and development costs:

ASC 985, "Software", 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 the completion of a working model. The Company does not incur material costs between the completion of a working model and the point at which the products are ready for general release. Therefore, research and development costs are charged to the statement of operations as incurred.

n. Government grants:

Royalty-bearing grants from the Government of Israel for funding certain approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the related costs incurred and recorded as a deduction of research and development costs. The Company recorded a grant in the amount of $ 10 in 2011. The Company did not receive any grants during the years ended December 31, 2012 and 2013, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

o. Income taxes:

The Company accounts for income taxes in accordance with ASC Topic 740, "Income Taxes" ("ASC 740"). ASC 740 prescribes the use of the liability method, according to which 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. Valuation allowances are provided to reduce deferred tax assets to their estimated realizable value.

ASC 740 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 ASC 740, 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.

p. Accounting for stock-based compensation:

The Company applies ASC 718 "Compensation - Stock Compensation", and ASC 505-50 "Equity-Based Payments to Non-Employees", with respect to options and warrants issued to non-employees. ASC 718 requires the use of an option valuation model to measure the fair value of the options and warrants at the measurement date as defined in ASC 505-50.

ASC 718 requires companies to estimate the fair value of stock-based awards on the date of grant using an option-pricing model, where applicable. Stock-based compensation expense recognized in the Company's consolidated statements of operations for 2011, 2012 and 2013 include compensation expense for stock-based awards granted based on the grant date fair value estimated in accordance with the provisions of ASC 718.

The Company recognizes these compensation costs net of a forfeiture rate and recognizes the compensation costs for only those shares expected to vest on an accelerated method over the requisite service period for each separately vesting portion of the award, which is the option vesting term of four years. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company estimates the fair value of stock options granted using the Black-Scholes-Merton option pricing model ("Black-Scholes"). No options were granted during 2012. The fair value for options granted in 2011 and 2013 was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

	Year ended December 31,		
Stock options	2011	2012	2013
Expected volatility (1)	100%-101.4%	-	91.4%-100.3%
Risk-free interest (2)	0.37%-0.41%	-	0.35%-0.78%
Dividend yield (3)	0%	-	0%
Expected life (years) (4)	3.75	-	3.34-3.75

(1) Expected volatility is estimated based upon actual historical stock price movements over an historical period equivalent to the option's expected term;

(2) The risk-free interest rate for purposes of the Black-Scholes price calculation is based on the yield from U.S. Treasury Bonds with an equivalent term;

(3) The dividend yield is estimated to be 0% as the Company has historically not paid dividends and has no foreseeable plans to pay dividends.

(4) Expected term of options granted represents the period of time that options granted are expected to be outstanding, and is estimated based on the Company's history.

q. Fair value of financial instruments:

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

The carrying amounts of cash and cash equivalents, restricted cash, restricted marketable securities, trade receivables, other accounts receivable and trade payables approximate their fair value, due to the short-term maturity of such instruments.

The Company applies ASC 820 which clarifies that 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. As a basis for considering such assumptions, ASC 820 establishes a three-tier value hierarchy, which prioritizes the 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 - Include other inputs that are directly or indirectly observable in the marketplace.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Level 3 - Unobservable inputs which are supported by little or no market activity.

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.

Assets measured at fair value under ASC 820 on a recurring basis as of December 31, 2013 were presented in the Company's consolidated balance sheet as follows:

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Marketable securities	$ 153	$ 153	-	-

r. Concentrations of credit risk:

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

Cash and cash equivalents are deposited with major banks in Israel and in the United States. Such deposits in the United States may be in excess of insured limit 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, minimal credit risk exists with respect to these investments.

The Company’s customers are located mainly in the United States (see Note 12). The Company performs ongoing credit evaluations of its customers. In certain circumstances, the Company may require letters of credit, other collateral or additional guarantees. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection according to management estimates.

The Company's restricted marketable securities include investments in equity securities and Israeli government securities. Management believes that the portfolio is well diversified, and accordingly, minimal credit risk exists with respect to these marketable securities. The Company has no off-balance-sheet concentrations of credit risk.

s. Basic and diluted net earnings per share:

The Company accounts for net earnings per share based on ASC 260,"Earning Per Share", which requires companies to compute both basic and diluted earnings per share, and to disclose the methodology used for the calculations. Basic

earnings per share are calculated using the weighted average number of shares outstanding during the period. Diluted earnings per share are computed on the basis of the weighted average number of shares outstanding and the effect of their dilutive potential during the period.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Basic net earnings per share are computed based on the weighted average number of Ordinary shares outstanding during each year. In 2011 all outstanding stock options were excluded from the calculation of the diluted net earnings (loss) per ordinary share since those options were anti-dilutive for the period. In 2012 and in 2013, 52,707 and 61,736, respectively, options have been included in the calculation of the diluted net earnings per Ordinary Share, the effect on the above-mentioned amount was immaterial.

t. Derivatives and hedging:

ASC 815, "Derivatives and Hedging", as amended, requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings. The Company uses derivatives to hedge certain cash flow foreign currency exposures in order to further reduce the Company's exposure to foreign currency risks.

The Company entered into put option contracts to hedge certain transactions denominated in foreign currencies. The purpose of the Company's foreign currency hedging activities is to protect the Company from risk that the eventual dollar cash flows from international activities will be adversely affected by changes in the exchange rates. The Company's put option contracts did not qualify as hedging instruments under ASC 815.

Changes in the fair value of put option contracts are reflected in the consolidated statements of operations as financial income or expense.

During 2011, 2012 and 2013, the Company entered into forward, call and put option contracts in the aggregated notional amount of $ 5,350, $ 3,750 and $ 2,400, respectively, that converted a portion of its floating currency liabilities to a fixed rate basis, thus reducing the impact of the exchange rate fluctuations on the Company's cash flow. In 2011, 2012 and 2013, the revaluation profit from these contracts with respect to the above transactions were $ 10, $ 47 and $ 65, respectively, and are presented in the statements of operations as financial expense, net. As of December 31, 2013, the Company had outstanding call and put option contracts in the amount of $900.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

u. Comprehensive income:

The Company accounts for comprehensive income in accordance with ASC Topic 220, "Comprehensive Income". This statement establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in stockholders' equity during the period except those resulting from investments by, or distributions to, stockholders. In May 2011, the FASB issued guidance that changed the requirement for presenting "Comprehensive Income" in the consolidated financial statements. The update requires an entity to present the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company adopted this new guidance on January 1, 2012 and elected to present the comprehensive income in two separate but consecutive statements.

Refer also to Note 2.w.1 below.

v. Reclassification:

Certain amounts in prior years have been reclassified to conform to the current year's presentation.

w. Impact of recently issued accounting standards

1. In February 2013, the FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income". Under ASU 2013-02, an entity is required to provide information about the amounts reclassified out of Accumulated Other Comprehensive Income ("AOCI") by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 was effective for the Company as of January 1, 2013. This standard only impacts presentation and disclosure requirements. The Company adopted this new guidance on January 1, 2013 and the adoption did not have a material effect on our consolidated financial statements.

2. In July 2013, the FASB issued a new accounting standard that will require the presentation of certain unrecognized tax benefits as reductions to deferred tax assets rather than as liabilities in the consolidated balance sheets when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists.

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NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company will be required to adopt this new standard on a prospective basis in the first quarter of fiscal 2015; however, early adoption is permitted as a retrospective application. The Company is currently evaluating the impact of this new standard on its consolidated financial statements.

NOTE 3:- MARKETABLE SECURITIES

The following is a summary of the Company's accumulated gross unrealized gains/ losses from investment in marketable securities as of December 31, 2013:

	December 31, 2012				December 31, 2013			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair market value	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair Market Value
Available-for-sale:								
Equity securities	$ 81	$ 4	$ 7	$ 78	$ 65	$ 10	$ 1	$ 74
Corporate bonds	47	2	-	49	36	6	-	42
Israeli Government debt	11	1	-	12	34	3	-	37
	$ 139	$ 7	$ 7	$ 139	$ 135	$ 19	$ 1	$ 153

The net realized gains and (losses) on sales of available-for-sale securities of $ 2, $ (6) and approximately $ 1 in 2011, 2012 and 2013, respectively, were recorded in financial income.

The amortized cost and fair value of debt and securities as of December 31, 2012 and 2013, by contractual maturity, are shown below:

	December 31, 2012		December 31, 2013	
	Amortized cost	Fair market value	Amortized cost	Fair market value
Matures up to one year	$ 51	$ 54	$ 79	$ 87
Matures after one year through five years	41	42	28	32
Matures after five years	14	16	12	15
Equity securities - no definite maturity date	33	27	16	19
Total	$ 139	$ 139	$ 135	$ 153

The marketable securities are restricted in order to secure the Company's obligations under an office lease (see Note 8).

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NOTE 4:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2012	2013
Government authorities	$ 32	$ 12
Prepaid expenses	23	60
Lease deposits	53	41
Related parties	10	6
Others	57	28
	$ 175	$ 147

NOTE 5:- PROPERTY AND EQUIPMENT

	December 31,	
	2012	2013
Cost:		
Computers and peripheral equipment	$ 752	$ 813
Office furniture and equipment	185	186
Leasehold improvements	50	50
	987	1,049
Accumulated depreciation:		
Computers and peripheral equipment	564	678
Office furniture and equipment	141	151
Leasehold improvements	37	37
Accumulated depreciation	742	866
Depreciated cost	$ 245	$ 183

The depreciation expense for the years ended December 31, 2011, 2012 and 2013 amounted to $ 82, $ 102 and $124, respectively.

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NOTE 6:- INTANGIBLE ASSETS

a. Intangibles consist of the following:

	December 31,	
	2012	2013
Cost:		
Development technology	$ 2,170	$ 2,170
Customer relationships	1,015	1,015
Brand name	229	229
	3,414	3,414
Accumulated amortization:		
Development technology	1,675	1,798
Customer relationships	897	945
Brand name	83	104
	2,655	2,847
Amortized cost	$ 759	$ 567

b. Amortization expense amounted to $ 365, $ 291 and $192 for the years ended December 31, 2011, 2012 and 2013, respectively.

c. Estimated amortization expense for:

Year ended December 31,	
2014	$ 177
2015	167
2016	160
2017	21
2018-2019	42
	$ 567

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NOTE 7:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,	
	2012	2013
Employees and payroll accruals	$ 999	$ 1,013
Institutions and income tax payable	353	134
Accrued expenses	958	1,007
Related parties	83	46
	$ 2,393	$ 2,200

NOTE 8:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Lease commitments:

The Company and its subsidiaries lease office space and motor vehicles through operating leases. The facilities of the Company and its subsidiaries are leased for periods ending February 2019. Future minimum lease commitments under non-cancelable operating leases as of December 31, 2013 are as follows:

2014	$ 217
2015	78
2016	58
2017-2019	126
	$ 479

Lease expenses for the years ended December 31, 2011, 2012 and 2013 were approximately $ 573, $ 462 and $ 480, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 8:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

b. Royalty commitments:

The Company is committed to pay royalties to the Office of the Chief Scientist ("OCS") of the Ministry of Industry, Trade and Labor of the Government of Israel on proceeds from sales of products resulting from the research and development projects in which the OCS participated. In the event that development of a specific product in which the OCS participated is successful, the Company will be obligated to repay the grants through royalty payments at the rate of 3% to 5% based on the sales of the Company, up to 100%-150% of the grants received linked to the dollar. Grants received after January 1999 is subject to interest at a rate equal to the 12 month LIBOR rate. The obligation to pay these royalties is contingent upon actual sales of the products and, in the absence of such sales, no payment is required.

As of December 31, 2013, the Company had a contingent liability to pay royalties in the amount of approximately $ 8,638 plus interest for grants received after January 1999.

The Company has paid or accrued royalties in its cost of revenues relating to the repayment of such OCS grants in the amount of $ 219, $ 200 and $ 136 for the years ended December 31, 2011, 2012 and 2013, respectively.

c. Claims and demands:

1. In April 2000, the Israeli Tax Authorities (the "ITA") issued a demand to the Company for a tax payment for the period of 1997-1999 in the amount of approximately NIS 6,000 ($ 1,607 as of December 31, 2012). The Company appealed the demand to the Israeli Tel Aviv District.

In October 2012, the Tel Aviv District Court rendered its decision, according to which, the Company's claims were partly accepted and partly denied. According to the court ruling and the final assessment letter from the ITA, the Company had to pay approximately $ 1,430, of which $ 1,190 was paid during 2012 and $ 240 was paid in 2013.

2. Claims related to discontinued operations:

a) The Company is a party to various claims that arose in TABS Brazil. Accordingly, the Company recorded a provision of approximately $ 226 in respect of such claims in accordance with ASC 450, "Contingencies", based on the opinion of Company's management.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 8:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

b) During August 2007, TABS Brazil was ordered by the Labor Law Court in Brazil to pay approximately $ 71 to one of its former employees. Such amount bears a 1% interest rate per month from the date that the claim was filed. The Company recorded a provision in its financial statements for the total amount of the claim. As of December 31, 2013 total claims related to discontinued operations amounted to $ 362.

3. In September 2010, Asentinel LLC ("Asentinel"), a competitor of the Company, filed a patent infringement complaint against AnchorPoint (now known as The Info Group Inc.), from whom we purchased certain assets in December 2008, and two other defendants, in the United States District Court for the Western District of Tennessee. On December 2, 2011 the Company entered into a settlement agreement with Asentinel, according to which the Company made a lump sum payment for the alleged past damages, which was expensed in 2011, and Asentinel granted the Company a license to use certain of its patents in return for ongoing annual royalty payments for periods subsequent to January 1, 2012. During 2013 the Company recorded royalty payments in cost of revenues with respect to Asentinel in the amount of $ 48.

4. The Israeli Government, through the Fund for Encouragement of Marketing Activities, awarded C. Mer Industries Ltd., a related party of the Company grants for participation in foreign marketing expenses, partially related to the Company's marketing activities for the years 1996 - 1998. During 2012, the Company received through an affiliated company a demand with respect to the reimbursement of above-mentioned grants. As of December 31, 2012 and 2013, the Company made a provision in the amount that was considered probable.

d. Guarantees:

The Company provided a bank guarantee in the amount of $ 68 to secure its obligations under one of its lease agreements, see also Note 3.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- TAXES ON INCOME

a. Israeli taxation:

1. Corporate tax rates:

The Israeli corporate tax rate was 24% in 2011, 25% in 2012 and 25% in 2013.

On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among others, canceled effective from 2012, the scheduled progressive reduction in the corporate tax rate. The Law also increased the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly.

On July 30, 2013, the Israeli Parliament approved the second and third readings of the Economic Plan for 2013-2014 ("Amended Budget Law") which consists, among others, of fiscal changes whose main aim is to enhance the collection of taxes in those years. These changes include, among others, raising the Israeli corporate tax rate from 25% to 26.5% effective from January 1, 2014.

2. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 ("the Law"):

According to the Law, the Company is entitled to various tax benefits by virtue of the "approved enterprise" status granted to part of their enterprises, as implied by this Law. The principal benefits by virtue of the Law are:

According to the provisions of the Law, the Company has chosen to enjoy the "Alternative" track. Under this track, the Company is tax exempt in the first two years of the benefit period and subject to tax at the reduced rate of 10%-25% for a period of several years for the remaining benefit period.

Another condition for receiving the benefits under the alternative track is a minimum qualifying investment. This condition requires an investment in the acquisition of productive assets such as machinery and equipment which must be carried out within three years. The minimum qualifying investment required for setting up a plant is NIS 300. As for plant expansions, the minimum qualifying investment is the higher of NIS 300 and an amount equivalent to the "qualifying percentage" of the value of the productive assets. Productive assets that are used by the plant but not owned by it will also be viewed as productive assets. The Company was eligible under the terms of minimum qualifying investment and elected 2008 as its "year of election".

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- TAXES ON INCOME (Cont.)

The qualifying percentage of the value of the productive assets is as follows:

The value of productive assets before the expansion (NIS in millions)	The new proportion that the required investment bears to the value of productive assets
Up to NIS 140 (app. $ 40)	12%
NIS 140 - NIS 500 (app. $ 40-$ 144)	7%
More than NIS 500(app.$144)	5%

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

The benefit period starts with the first year the beneficiary enterprise earns taxable income, provided that 14 years have not passed since the approval was granted and 12 years have not passed since the enterprise began operating. In respect of expansion programs pursuant to Amendment No. 60 to the Investment Law, the benefit period starts at the later of the year elected and the first year the Company earns taxable income provided that 12 years have not passed since the beginning of the year of election. The respective benefit period has not yet begun.

The above benefits are contingent upon the fulfillment of the conditions stipulated by the Investment Law, regulations published there-under and the letters of approval for the investments in the approved enterprises, as above. Non-compliance with the conditions may cancel all or part of the benefits and refund of the amount of the benefits, including interest. Management believes that the Company is meeting the aforementioned conditions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- TAXES ON INCOME (Cont.)

Amendments to the Investment Law:

In December 2010, the "Knesset" passed the Investment Law for Economic Policy for 2011 and 2012 (Amended Legislation), 2011, which prescribes, among other things, amendments to the Investment Law. The amendment became effective as of January 1, 2011. According to the amendment, the benefit tracks in the Law were modified and a flat tax rate applies to the Company's entire preferred income. The Company will be able to opt to apply (the waiver is non-recourse) the amendment and from then on it will be subject to the amended tax rates that are: 2011 and 2012 - 15% (in development area A - 10%), 2013 and 2014 - 12.5% (in development area A - 7%) and in 2015 and thereafter - 12% (in development area A - 6%).

As of December 31, 2013, the Company chose not to adopt this amendment, but may elect to do so in the future.

3. Tax assessments:

The Company has received final tax assessments until the 2008 tax year.

4. Tax benefits under the Law for the Encouragement of Industry (Taxation), 1969:

The Law for the Encouragement of Industry (Taxation), 1969, provides several tax benefits for industrial companies. An industrial company is defined as a company resident in Israel, at least 90% of the income of which in a given tax year exclusive of income from specified government loans, capital gains, interest and dividends, is derived from an industrial enterprise owned by it. An industrial enterprise is defined as an enterprise whose major activity in a given tax year is industrial production activity.

MTS is currently qualified as an "industrial company" under the above definition 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 intangible property rights as a deduction for tax purposes.

Eligibility for benefits under the Law for the Encouragement of Industry (Taxation), 1969, is not subject to receipt of prior approval from any governmental authority. No assurance can be given that the Israeli Tax Authorities will agree that the Company qualifies, or, if the Company qualifies, then the Company will continue to qualify as an industrial company or that the benefits described above will be available to the Company in the future.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- TAXES ON INCOME (Cont.)

5. Tax Benefits for Research and Development:

Israeli tax law permits, under some conditions, a tax deduction for expenditures in the year incurred, including capital expenditures, in scientific research and development projects. The deduction is permitted if, among other things, the expenditures are approved by the relevant government ministry and the research and development is for the promotion of the enterprise and is carried out by, or on behalf of, a company seeking the deduction.

The OCS has approved some of the Company's research and development programs and the Company has been able to deduct, for tax purposes, a portion of its research and development expenses net of the grants received. Other research and development expenses that are not approved may be deducted for tax purposes in three equal installments during a three-year period.

b. Income taxes on non-Israeli subsidiaries:

Non-Israeli subsidiaries are taxed according to the tax laws in their respective countries of residence.

c. Net operating loss carry-forwards:

As of December 31, 2013, the Company and its subsidiaries in Hong Kong and the U.S. had an estimated total amount of available carry-forward tax losses of approximately $ 19,454, $ 285 and $ 539, respectively to offset against future taxable profits. The operating tax loss carry-forwards in Israel may be offset indefinitely against operating income. In addition, as of December 31, 2013, the Company had capital losses in the amount of approximately $ 417 that can be carried forward indefinitely.

MTS IntegraTRAK is subject to U.S. income taxes. Total net operating loss carry-forwards of approximately $ 539 as of December 31, 2013, will expire in the years 2021 to 2028. The Company's management believes that utilization of the U.S. net operating losses may be subject to substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. Such annual limitation may result in the expiration of net operating losses before utilization.

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- TAXES ON INCOME (Cont.)

d. Deferred income 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,	
Deferred tax assets:	2012	2013
Tax loss carry-forwards	$ 4,872	$ 5,377
Allowances for doubtful accounts and accruals for employee benefits	101	95
Intangible assets	118	103
Depreciation, accruals for interest and other	724	721
Deferred tax asset before valuation allowance	5,815	6,296
Goodwill	(658)	(674)
Valuation allowance	(4,786)	(5,651)
Deferred tax assets (liability), net	$ 371	$ (29)
Presented as follows:		
Short-term assets	$ 371	$ -
Long-term liability	-	(29)

MTS and certain of its subsidiaries have provided valuation allowances in respect of deferred tax assets resulting from tax loss carry-forwards and other temporary differences, since they have a history of losses incurred over the past years. Management currently believes that it is more likely than not that part of the deferred tax relating to the loss carry-forwards in the Company and its subsidiaries and other temporary differences will not be realized in the foreseeable future.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- TAXES ON INCOME (Cont.)

e. A reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income of the Company and the actual tax expense as reported in the statements of operations is as follows:

	Year ended December 31,		
	2011	2012	2013
Income before taxes on income, net, as reported in the statements of operations from continuing operations	$ 481	$ 2,102	$ 1,768
Tax rates	24 %	25 %	25 %
Theoretical tax expense (benefit)	$ 115	$ 526	$ 442
Increase in taxes resulting from:			
Effect of different tax rates	19	25	27
U.S. state tax	8	26	35
Utilization of carry-forward tax losses for which valuation allowance was provided	(2)	(380)	-
Taxes in respect of previous years as a result of court ruling	-	1,415	-
Changes in provision for uncertain tax positions	6	(362)	1
Change in valuation allowance	-	(340)	148
Deferred taxes for which valuation allowance was provided	(136)	(174)	(218)
Taxes on income, net, as reported in the statements of operations	$ 10	$ 736	$ 435

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9:- TAXES ON INCOME (Cont.)

f. Income before income taxes is comprised as follows:

	Year ended December 31,		
	2011	2012	2013
Domestic	$ 225	$ 1,808	$ 1,561
Foreign	256	294	207
	$ 481	$ 2,102	$ 1,768

g. Taxes on income are comprised as follows:

	Year ended December 31,		
	2011	2012	2013
Current taxes	$ 8	$ 26	$ 35
Deferred taxes	2	(340)	400
Taxes in respect of previous years as a result of court ruling	-	1,050	-
	$ 10	$ 736	$ 435
Foreign	$ 10	$ 57	$ 64

h. As of December 31, 2013, the Company had a liability for unrecognized tax benefits of $ 101. A reconciliation of the opening and closing amounts of unrecognized tax benefits is as follows:

	December 31,	
	2012	2013
Balance as of beginning of the year	$ 632	$ 100
Additions based on tax positions taken during the current period	3	1
Decrease based on tax positions taken during the current period	(535)	-
Balance at the end of the year	$ 100	$ 101

NOTE 10:- RELATED PARTY TRANSACTIONS AND BALANCES

a. The Company receives certain services from C. Mer Industries Ltd. or C. Mer, a publicly traded company. Mr. Chaim Mer, the Company's chairman of the board and Mr. Isaac Ben Bassat, a director of the Company, are members of the controlling group of C. Mer. These services include reimbursement for shared expenses related to a commercial insurance policy. For the years ended December 31, 2011, 2012 and 2013, the Company paid or accrued $ 16, $ 13 and $ 16, respectively, with respect to the above mentioned expenses. In 2012 MTS Ltd. engaged with Mer Telecom Ltd., a subsidiary of C. Mer, in a deployment of its Mobile Financial Services (MFS) solution for a customer in Africa and completed the deployment in 2013. The Company recorded revenue in the amount of $ 0 and $ 29 in 2012 and 2013, respectively. As of December 31, 2013 the solution was implemented, but the customer has not yet activated the solution.

From January 1, 2009 until September 2011, as part of the acquisition of certain assets and liabilities of AnchorPoint, the Company received certain services from Data Distributors Inc., a company controlled by Mr. Roger Challen, a director of the Company and the controlling shareholder of the Info Group Inc., a beneficial owner of 23.5% of the Company’s Ordinary shares. These services include reimbursement for shared expenses, development and IT services, other administrative services, and rental related fees. Expenses recognized with respect to the above mentioned services were approximately $ 195, $ 0 and $ 0 for the year ended December 31, 2011, 2012 and 2013, respectively. In addition, the Company rents an office in Powder Springs, Georgia, from Mr. Challen, under a month-to-month lease. For the year ended December 31, 2013, the Company paid or accrued $ 56 with respect to the above mentioned rent expenses.

On March 25, 2009, the Company's Audit Committee and Board of Directors approved a transaction with Mer& Co. (1982) Ltd., or Mer & Co, a subsidiary of C. Mer. According to the terms of the transaction, the Company will sell its products to Mer & Co, which has an Israel Defense Forces approved supplier number, and Mer & Co will represent the Company and resell its products to the Israeli Defense Forces. During 2013, revenues from the abovementioned transaction amounted to $ 45.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 10:- RELATED PARTY TRANSACTIONS AND BALANCES (Cont.)

b. Balances and transactions with related parties were as follows:

1. Balances with related parties:

	December 31,	
	2012	2013
Other accounts payable and accrued expenses (see Note 7)	$ 83	$ 46
Other accounts receivable and prepaid expenses (see note 4)	$ 10	$ 6

2. Transactions with related parties:

	Year ended December 31,		
	2011	2012	2013
Revenues derived from a related party	$ 103	$ 101	$ 74
Amounts charged by related parties:			
Cost of revenues	$ *54	$ 53	$ 16
Operating expenses	323	121	195
	$ 377	$ 174	$ 211

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- SHAREHOLDERS' EQUITY

a. Share capital:

The Ordinary shares entitle their holders the right to receive notice to participate in and vote at general meetings of the Company and the right to receive cash dividends, if declared.

b. Stock options:

MTS has authorized, through its 1996 Incentive Share Option Plan ("the Plan"), the grant of options to officers, management, employees and directors of MTS or any subsidiary of up to 750,000 of MTS's Ordinary shares, which may be granted under the Plan, pursuant to section 102 of the Israel Income Tax Ordinance. Any option, which is canceled or forfeited before expiration, will become available for future grants.

Each option granted under the Plan is exercisable until the earlier of five years from the date of the grant of the option or the expiration dates of the option plan. The exercise price of the options granted under the plans may not be less than the nominal value of the shares into which such options were exercised. The options primarily vest gradually over four years of employment.

In 2003, pursuant to an amendment in section 102 of the Israeli Income Tax Ordinance the Company rolled-over the remaining 446,958 options available at that time under the Plan for future grants under the 2003 Incentive Share Option Plan ("the 2003 Plan") that conforms with the newly amended provisions of section 102 of the Israel Income Tax Ordinance. In August 2013, shareholders approved amendments to the 2003 Plan. Its term was extended by ten years so that the 2003 Plan will expire on November 30, 2023, unless further extended. The number of ordinary shares issuable under the 2003 Plan was increased by an additional 500,000 ordinary shares, so that the Company is entitled to issue up to 946,957 ordinary shares under the 2003 Plan.

In June 2006, the Company authorized pursuant to its 2006 Stock Option plan ("the 2006 Plan"), the grant of options to officers, management, employees and directors of MTS IntegraTRAK or any subsidiary of up to 200,000 of the Company's Ordinary shares. Each option granted under the 2006 Plan will be either an option intended to be treated as an "incentive stock option", within the meaning of section 422 of the Internal Revenue Code of 1986, as amended, or an option that will be treated as a "non-qualified stock option".

At the Company's 2011 annual general meeting, shareholders approved an amendment to the 2006 Plan to provide for the issuance thereunder of an additional 200,000 Ordinary shares and to increase the total number of Ordinary shares with respect to which options may be granted there-under to any eligible employee during any 12 month period to 150,000 Ordinary shares, subject to adjustment as provided in the 2006 Plan.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

At the Company’s 2013 annual general meeting, shareholders approved an amendment to the 2006 Plan to provide for the issuance thereunder of an additional 150,000 post-reverse split ordinary shares, such that the Company will be entitled to issue options to purchase up to 550,000 Ordinary shares under the 2006 Plan. Each option granted under the 2006 Plan is exercisable until the earlier of five years from the date of the grant of the option or the expiration dates of the option plan. The exercise price of the options granted under the 2006 Plan may not be less than the fair market value of an Ordinary share determined as of the date of grant of the option.

During 2013, 35,250 options were exercised under the 2003 and 2006 Plans.

As of December 31, 2013, 844,536 Ordinary shares are available for future option grants.

c. A summary of option activity under the Company's stock option plans to its employees as of December 31, 2013 and changes during the year ended December 31, 2013 are as follows:

	Number of options	Weighted-average exercise price	Weighted-average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at December 31, 2012	276,750	$ 1.70	3.01	$ 513
Granted	172,000	$ 2.18	4.47	
Exercised	(30,500)	$ 1.99	-	
Expired and forfeited	(15,000)	$ 2.15	-	
Outstanding at December 31, 2013	403,250	$ 1.86	3.11	$ 289.14
Vested and expected to vest	380,290	$ 1.86	3.08	$ 273.88
Exercisable at December 31, 2013	116,250	$ 1.73	1.81	$ 98.4

The weighted average grant-date fair value of options granted during 2011 and 2013 was $ 0.87 and $ 1.45 per option, respectively. During 2012 there were no option grants.

The total compensation cost related to options granted to employees under the Company's share-based compensation plans recognized for the years ended December 31, 2011, 2012 and 2013 amounted at $ 65, $ 41 and $ 93, respectively, net of estimated forfeitures.

As of December 31, 2013, there was $ 182 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

Company's stock option plans. That cost is expected to be recognized over a weighted-average period of three years.

d. Total stock-based compensation expenses recognized in 2011, 2012 and 2013:

The total stock-based compensation expense related to employees' equity-based awards, recognized for the years ended December 31, 2011, 2012 and 2013, was comprised as follows:

	Year ended December 31,		
	2011	2012	2013
Cost of revenues	$ 3	$ -	$ 7
Research and development expenses	8	1	7
Selling and marketing	4	1	-
General and administrative expenses	50	39	79
	$ 65	$ 41	$ 93

e. Options to non-employees:

Issuance date	In connection with	Number of options granted	Options exercisable	Exercise price per share	Exercisable through
November 9, 2011	consultant	2,500	2,500	1.94	May 2014
August 8, 2013	consultant	40,000	-	2.08	August 2018

At the Company’s 2013 annual general meeting, shareholder approved the grant of options to one of the Company’s consultants, who also serves as a director of the Company, to purchase 40,000 ordinary shares.

In November 2011, the Company granted 7,250 options to a consultant. The Company accounted for its outstanding options to non-employees under the fair value method of ASC 718 and ASC 505-50. The fair value for these options was estimated at the measurement date using the Black-Scholes option-pricing model. During 2013 the consultant exercised 4,750 options. Compensation expense related to the grant of stock options to non-employees amounted to $ 2, $ 3 and $ 14 for the years ended December 31, 2011, 2012 and 2013, respectively.

MER TELEMANAGEMENT SOLUTIONS LTD.
AND ITS SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 12:- REPORTABLE SEGMENTS AND GEOGAPHIC INFORMATION

a. Reportable segments:

The Chief Operating Decision Maker ("CODM") assesses the Company's business based on two operating segments: Enterprise and Service Providers. Enterprise includes Telecom Expenses Management solutions ("TEM") and services and solutions. Service Providers, includes billing and Mobile Virtual Network Operator ("MVNO") services and solutions. These two segments also comprise the Company's reporting units. The CODM uses adjusted net income before interest, tax, depreciation and amortization, capital gain and stock based compensation ("adjusted EBITDA"), to assess performance, measure liquidity and make decisions. Adjusted EBITDA is a non-GAAP unaudited measure of profit and loss.

The Company's segments are engaged in business activities for which they earn revenues and incur expenses, their results are reviewed by the CODM and discrete financial information is available.

Asset information, by reportable segment, is not reviewed by the CODM, therefore segment asset disclosure is not included.

The following tables present the financial information for the Company's reportable segments.

	Year ended December 31,		
	2011	2012	2013
Enterprise:			
Revenue	$ 9,232	$ 9,041	$ 7,817
Adjusted EBITDA (Unaudited)	$ 555	$ 1,701	$ 1,231
Service providers:			
Revenue	$ 2,771	$ 4,085	$ 4,655
Adjusted EBITDA (Unaudited)	$ 360	$ 778	$ 899
Segments total:			
Revenue	$ 12,003	$ 13,126	$ 12,472
Adjusted EBITDA (Unaudited)	$ 915	$ 2,479	$ 2,130

MER TELEMANAGEMENT SOLUTIONS LTD.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 12:- REPORTABLE SEGMENTS AND GEOGAPHIC INFORMATION (Cont.)

A reconciliation of total adjusted EBITDA to net income for each year is as follows:

	Year ended December 31,		
	2011	2012	2013
Adjusted EBITDA(Unaudited)	$ 915	$ 2,479	$ 2,130
Depreciation and amortization expenses	447	393	316
Stock-based compensation	67	44	$ 107
Capital gain	(78)	-	-
Financial income, net	(2)	(60)	(61)
Income tax expenses	10	736	435
Net income from continuing operations	$ 471	$ 1,366	$ 1,333

The total revenues from external customers are attributed to geographic areas based on the location of the customer:

	Year ended December 31,		
	2011	2012	2013
United States	$ 8,915	$ 10,251	$ 10,817
Germany	683	482	252
Far East	585	443	300
Holland	317	297	216
Israel	732	917	400
Other	771	736	487
	$ 12,003	$ 13,126	$ 12,472

Revenues from a major customer accounted for 16%, 23% and $ 33% of total revenues for the years ended December 31, 2011, 2012 and 2013, respectively.

	December 31,	
	2012	2013
Long-lived assets:		
Israel	$ 1,586	$ 1,348
United States	2,892	2,876
Other	5	5
	$ 4,483	$ 4,229

S I G N A T U R E S

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

MER TELEMANAGEMENT SOLUTIONS LTD.

By: /s/ Eytan Bar
Eytan Bar
Chief Executive Officer

By: /s/ Alon Mualem
Alon Mualem
Chief Financial Officer

Dated: March 12, 2014