RADA ELECTRONIC INDUSTRIES LTD
Form 20-F
April 16, 2004

SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
FORM 20-F

[ ] REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12 (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, 2003
or
[X] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number: 0-15375

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

Israel
(Jurisdiction of Incorporation or Organization)

7 Giborei Israel Street, Netanya 42504, Israel
(Address of Principal Executive Offices)

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

None

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

Ordinary Shares, NIS 0.005 Par Value
(Title of Class)

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

None
(Title of Class)

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

Ordinary Shares, par value NIS 0.005 per share.....18,542,383

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

Yes X No __

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

Item 17 __ Item 18 X

This annual report on Form 20-F is incorporated by reference into the registrant's Registration Statement on Form F-3, Registration No. 333-12074.

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This Annual Report on Form 20-F contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and within the Private Securities Litigation Reform Act of 1995, as amended. Such forward-looking statements reflect our current view with respect to future events and financial results. Forward-looking statements usually include the verbs "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "understands" and other verbs suggesting uncertainty. 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. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Unless specifically indicated otherwise, all numbers of ordinary shares and per share data in this annual report reflect a two and one half share for one share reverse stock split of our ordinary shares effected on April 4, 2001.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

We derived the following consolidated statements of operations data for the years ended December 31, 2001, 2002 and 2003 and the consolidated balance sheet data as of December 31, 2002 and 2003 from our audited consolidated financial statements and notes included in this annual report. We derived the consolidated statements of operations data for the years ended December 31, 1999 and 2000, and the consolidated balance sheet data as of December 31, 1999, 2000 and 2001 from our audited consolidated financial statements that are not included in this annual report.

	Year Ended December 31,				
	1999	2000	2001	2002	2003
	(U.S. dollars in thousands, except per share data)				
INCOME STATEMENT DATA:					
Revenues	$10,373	$3,816	$8,342	$10,399	$12,31
Cost of revenues	12,707	5,307	7,416	9,223	9,59

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	Year Ended December 31,				
	1999	2000	2001	2002	2003
	(U.S. dollars in thousands, except per share data)				
Gross profit (loss)	(2,334)	(1,491)	926	1,176	2,72
Research and development expenses	428	730	534	122	
Marketing, selling, general and administrative expenses	4,316	3,612	3,617	3,809	2,69
Operating income (loss) from continuing operations	(7,078)	(5,833)	(3,225)	(2,035)	2
Financial income (expenses), net	(1,141)	(861)	(210)	(364)	70
Other income (expenses), net	505	563	(30)	(290)	(
Operating income (loss)	(7,714)	(6,131)	(3,465)	(2,689)	73

Equity in loss of affiliated company..	(101)	-	-	-	
Minority interest in losses of subsidiary.....	292	32	96	206	2
Income (loss) from continuing operations.....	(7,523)	(6,099)	(3,369)	(2,483)	75
Gain from disposal of discontinued segment (net of tax).....	306	-	-	-	
Net income (loss).....	$(7,217)	$(6,099)	$(3,369)	$(2,483)	$75
Basic net income (loss) per share from continuing operations.....	$(0.77)	$(0.46)	$(0.24)	$(0.15)	$0.0
Diluted net income (loss) per share from continuing operations	$(0.77)	$(0.46)	$(0.24)	$(0.15)	$0.0
Basic income per share from discontinued operations.....	$ 0.03	$ -	$ -	$ -	$
Diluted net income per share from discontinued operations.....	$ 0.03	$ -	$ -	$ -	$
Basic net earnings (loss) per share...	$(0.74)	$(0.46)	$(0.24)	$(0.15)	$0.0
Diluted net earnings (loss) per share.	$(0.74)	$(0.46)	$(0.24)	$(0.15)	$0.0
Weighted average number of shares used to compute basic net income(loss) per share.....	9,722	13,305	13,817	16,555	18,51
Weighted average number of shares used to compute diluted net income (loss) per share.....	9,722	13,305	13,817	16,555	19,70

	As of December 31,				
	1999	2000	2001	2002	2003
	(U.S. dollars in thousands)				
BALANCE SHEET DATA:					
Working capital deficiency.....	$(8,419)	$(8,668)	$(9,446)	$(8,055)	$(2,71
Total assets.....	19,918	18,874	16,332	14,607	14,54
Short-term credits and current maturities of long-term debt.....	5,378	5,624	5,920	5,697	1,12
Long-term debt, net of current maturities	811	8	-	-	1,22
Shareholders' equity.....	4,329	4,069	700	485	2,87

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

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

Risks Related to Our Business and Our Industry

We have a history of losses, and may not be able to maintain profitable operations in the future.

We reported a net profit of $758,000 for the fiscal year ended December 31, 2003. As of December 31, 2003 our accumulated deficit was $57.7 million. No assurance can be given that we will be able to maintain our current level of revenues and profitability in the future.

We may need to raise additional capital in the future, which may not be available to us.

Our working capital requirements and the cash flow provided by our operating activities are likely to vary greatly from quarter to quarter, depending on the timing of orders and deliveries, the build-up of inventories, and the payment terms offered to our customers. As a consequence of our significant losses, we incurred significant bank debt and sold equity and debt securities in private placements in the years 1997 through 2003. In June 2003 we reached a settlement agreement with Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M. that significantly improved our financial position. We may need to raise additional funds for a number of uses, including:

- working capital and operating activities;
- implementing marketing and sales activities for our products;
- maintaining and expanding research and development programs;
- hiring additional qualified personnel; and
- supporting an increased level of operations.

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

- develop new products;
- enhance our existing products;

- remain current with evolving industry standards;
- fulfill our contractual obligations;
- take advantage of future opportunities;
- respond to competitive pressures or unanticipated requirements; or
- retain our listing on the Nasdaq SmallCap Market.

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

We cannot assure you that our shareholders or our banks will continue to provide sufficient funds to finance our operations.

During the four years ended December 31, 2003, we relied predominately on our principal shareholders and to a lesser degree on new investors to provide us with working capital. During this period, they provided us with $13.1 million in equity capital, convertible debt and loans. In June 2003 we also reached an agreement with Bank Hapoalim B.M. and Bank Leumi Le Israel B.M. to restructure $3,451,000 of our debt to them. Pursuant to the agreement, we paid the Banks $1,100,000 on account of our debt to them and they forgave $1,100,000 in debt and agreed to accept warrants to purchase 3,781,995 of our ordinary shares, exercisable at par value per share, to purchase ordinary shares in lieu of $1,251,000 of debt. We cannot assure you that our shareholders or Banks will continue to provide us with funds when requested, and that such funds, if any, will be sufficient to finance our operations. The failure of our principal shareholders or other investors to provide us with the necessary financing may result in a significant scaling back or elimination of some aspects of our operations.

Our growth strategy is based on our forming close business relationships and cooperation with major aerospace corporations; should these relationships not materialize into significant agreements or existing contracts fail to be profitably implemented, we may not be able to implement our growth strategy.

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

Competition in the market for automated test equipment and avionics equipment is intense and we may be unable to achieve profitability.

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

Our initiative of providing manufacturing services may not succeed, and as a result, we may be unable to achieve profitability in our Beit-Shean production facility and may be forced to shut down its operations.

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

Reduction in military budgets worldwide may cause a reduction in our revenues, which would adversely affect our business, operating results and financial condition.

A significant portion of our revenues is derived from the sale of products with military applications. These revenues, on a consolidated basis, totaled approximately $9.6 million, or 78% of revenues in 2003, $6.9 million, or 66% of revenues, in 2002 and $3.1 million, or 37% of revenues, in 2001. The military budgets of a number of countries may be reduced in the future. Declines in government military budgets may result in reduced demand for our products and manufacturing services. This would result in reduction in our core business' revenues and adversely affect our business, results of operations and financial condition.

Sales of our products are subject to governmental procurement procedures and practices; termination, reduction or modification of contracts with our customers, and especially with the Government of Israel, or a substantial decrease in our customers' budgets may adversely affect our business, operating results and financial condition.

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

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

If we do not receive the governmental approvals necessary for the export of our products, our revenues may decrease. Similarly if our suppliers and partners do not receive their government approvals necessary to export to us their products or designs, our revenues might decrease and we may fail to implement our growth strategy.

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

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

We depend on sales to key customers and the loss of one or more of our key customers would result in a loss of a significant amount of our revenues.

A significant portion of our revenues is derived from a small number of customers. Our major customers during the three years ended December 31, 2003 were as follows:

	Percentage of Revenues

	2001	2002	2003
Smiths Electronic Systems.....	6%	34%	22%
The Boeing Company.....	16%	19%	14%
Israeli Ministry of Defense.....	12%	3%	11%
Israel Aviation Industries.....	2%	6%	12%
Portuguese Air Force.....	-	4%	19%
Tarom Romanian Air Transport.....	17%	1%	-

We anticipate that a significant portion of our future revenues will continue to be derived from sales to a small number of customers. Further, in accordance with our growth strategy, we are attempting to expand the number of our customers while building long-term relationships with them. If our principal customers do not continue to purchase products from us at current levels or if such customers are not retained and we are not able to derive sufficient revenues from sales to new customers to compensate for their loss, our revenues would be reduced and adversely affect our business, financial condition and results of operations.

We depend on a limited number of suppliers of components for our products and if we are unable to obtain these components when needed, we would experience delays in manufacturing our products and our financial results could be adversely affected.

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

We rely on the airline industry and the continued financial crises in this industry adversely affect our sales.

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

Rapid technological changes may adversely affect the market acceptance of our products.

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

We may encounter difficulties with our international operations and sales.

While our principal executive offices are located in Israel, 74% of our sales in 2003, 86% of our sales in 2002 and 76% of our sales in 2001 were export. This subjects us to many risks inherent in international business, including:

- limitations and disruptions resulting from the imposition of government controls;
- changes in regulatory requirements;
- export license requirements;
- economic or political instability;
- trade restrictions;
- changes in tariffs;
- currency fluctuations;
- longer receivable collection periods and greater difficulty in accounts receivable collection;
- greater difficulty in safeguarding intellectual property;
- difficulties in managing overseas subsidiaries and international operations; and
- potential adverse tax consequences.

We cannot assure you that we will be able to sustain or increase revenues from international operations or that we will not encounter significant

difficulties in connection with the sale of our products in international markets or that one or more of these factors will not have a material adverse effect on our future revenues and, as a result, our business, operating results and financial condition.

Currency exchange rate fluctuations in the world markets in which we conduct business could have a material adverse effect on our business, results of operations and financial condition.

We may be adversely affected by fluctuations in currency exchange rates. While our revenues are generally denominated in U.S. dollars, a significant portion of our expenses is incurred in NIS. We do not currently engage in any currency hedging transactions intended to reduce the effect of fluctuations in foreign currency exchange rates on our results of operations. If we were to determine that it was in our best interests to enter into any hedging transactions in the future, there can be no assurance that we will be able to do so or that such transactions, if entered into, will 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. There can be no assurance such fluctuations in the future will not have a material adverse effect on revenues from international sales, and consequently, on our business, operating results and financial condition.

We are dependent on our senior management and key personnel, in particular Herzle Bodinger, our president and chairman of the board, whose loss would adversely affect our business.

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

Our proprietary technology is difficult to protect and unauthorized use of our proprietary technology by third parties may impair our ability to compete effectively.

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

Our products may infringe on the intellectual property rights of others.

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

We may not be able to receive title to the land and buildings of our Chinese

subsidiary and may be required to initiate litigation in order to enforce our rights to receive title to such properties.

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

Risk Factors Related to Our Ordinary Shares

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

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

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

- de-listing of our shares from the Nasdaq SmallCap Market; and
- stock market price and volume fluctuations.

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

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

We may be delisted from the Nasdaq Stock Market if we fail to meet its listing maintenance requirements.

Our shares have traded on the Nasdaq Stock Market since 1985 and on Nasdaq SmallCap Market since June 10, 2002. During periods of 2002 and 2003, we were not in compliance with Nasdaq's continued listing requirements as our shareholders' equity fell below the Nasdaq minimum requirement of $2.5 million. As a result of our agreement with our Banks, we achieved compliance, and in November 2003, a Nasdaq Listing Qualification Panel issued a decision to continue the listing of our shares on the Nasdaq SmallCap Market. However, the panel required us to timely file reports with the SEC and Nasdaq evidencing that our shareholders' equity as of December 31, 2003 and June 30, 2004 exceeds $2.5 million. While we met this requirement as of December 31, 2003, we cannot assure you that our shareholders' equity will continue to be greater than $2.5 million or that we will be able to satisfy the other listing maintenance requirements. Furthermore, even if our current listing is maintained, in the event we incur losses in the future, we would be required to raise additional capital in order to maintain our listing on the Nasdaq SmallCap Market. Should we fail to raise the necessary capital in order to satisfy such requirements, our ordinary shares may be delisted from the Nasdaq SmallCap Market and transferred to the OTC Bulletin Board.

We do not intend to pay dividends.

We have never declared or paid any cash dividends on our ordinary shares. We currently intend to retain future earnings, if any, to finance operations and expand our business and, therefore, do not expect to pay any dividends in the foreseeable future.

Risks Relating to Our Location in Israel

Conducting business in Israel entails special risks.

We are incorporated under the laws of, and our executive offices, manufacturing plant and research and development facilities are located in, the State of Israel. Although most of our sales are made to customers outside Israel, we are nonetheless directly affected by the political, economic and military conditions affecting Israel. Specifically, we could be adversely affected

by any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in

the economic or financial condition of Israel.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Since September 2000, there has been a marked increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza. There is no indication as to how long the current hostilities will last or whether there will be any further escalation. Any further escalation in these hostilities or any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. Furthermore, there are a number of countries that restrict business with Israel or Israeli companies. Restrictive laws or policies of those countries 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.

Many of our executive officers and employees in Israel are obligated to perform up to 36 days, depending on rank and position, of military reserve duty annually and are subject to being called for active duty under emergency circumstances. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

The economic conditions in Israel have not been stable in recent years.

In recent years Israel has been going through a period of recession in economic activity, resulting in low growth rates and growing unemployment. Our operations could be adversely affected if the economic conditions in Israel continue to deteriorate. In addition, due to significant economic measures proposed by the Israeli Government, there have been several general strikes and work stoppages in 2003 and 2004, affecting banks, airports and ports. These strikes have had an adverse effect on the Israeli economy and on business, including our ability to deliver products to our customers. Following the passage by the Israeli Parliament of laws to implement the economic measures, the Israeli trade unions have threatened further strikes or work-stoppages, and these may have a material adverse effect on the Israeli economy and on us.

We may be adversely affected if the rate of inflation in Israel exceeds the rate of devaluation of the NIS against the U.S. dollar.

In 2003 approximately 25% of our expenses were in U.S. dollars or U.S. dollar-linked NIS, in 2002 approximately 39% of our expenses were in U.S. dollars or U.S. dollar-linked NIS and in 2001 approximately 45% of our expenses were in U.S. dollars or U.S. dollar-linked NIS.

In each of these years, virtually all our remaining expenses were in unlinked NIS. Our expenses that are denominated in U.S. dollars or paid in Israeli currency linked to the U.S. dollar-NIS exchange rate are influenced by the

extent to which any inflation in Israel is not offset (or is offset on a lagging basis) by the devaluation of the NIS in relation to the U.S. dollar. In 1998, 2001 and 2002 the rate of devaluation of the NIS against the dollar exceeded the rate of inflation in Israel, which benefited us. In 1999 and 2000 the rate of inflation exceeded the rate of devaluation of the NIS against the U.S. dollar. In 2003 the rate of inflation was negative and the NIS was revaluated vis-a-vis the dollar. These changes, as well as the recent world-wide devaluation of the U.S. dollar, have affected our operations, financial condition and results of operations by decreasing the NIS equivalents of our U.S denominated revenues and increasing the U.S. dollar equivalents of our NIS denominated expenses. We cannot assure you that we will not be materially adversely affected in the future if the rate of inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of this devaluation lags behind increases in inflation in Israel.

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

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

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

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

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

Your rights and responsibilities as a shareholder will be governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, our articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an

Israeli company has a duty to act in good faith toward the company and other shareholders and to refrain from abusing his power in the company, including,

among other things, in voting at the general meeting of shareholders on certain matters.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

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

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

In April 1985, we completed an initial public offering. We have traded on the Nasdaq National Market under the symbol RADIF since our initial public offering in 1985 until June 10, 2002 when the listing of our ordinary shares was transferred to the Nasdaq SmallCap Market.

B. BUSINESS OVERVIEW

Our Core Business

During 2002, we redefined our core business to being "solution-based" rather than product-based. Our recent business successes led us to the conclusion that our added value is in providing complete solutions that include our products as part of a package rather than simply selling specific products. In 2003 we further expanded our product range and have added additional functions which extended our product capabilities. As a result, we are now in a position to provide integrated solutions based on a number of our products to form a complete system.

Our core business currently includes the following activities:

- Integrated training solutions;
- Advanced fleet maintenance management solutions;
- Integrated weapons management systems;
- Data acquisition and management systems;

- UAV avionics;

- Automatic testing solutions; and
- Manufacturing services.

Our core business activity is based in Israel. Our U.S.-based subsidiaries have been inactive since January 1, 2002.

Integrated Training Solutions

Our training solutions are based on a complete and integrated system that includes an airborne component, installed onboard the aircraft, and a ground component, installed in a squadron's ground facility. Recent technology that we have developed, mainly for the Israeli Air Force, allows us to adapt the system to any kind of aircraft, regardless of its onboard avionics systems. Our solution also allows the integration of our airborne system with either an analog or digital video recorder and to provide a squadron information management network (SIM Net) as a ground component.

Autonomous Air Combat Evaluation System - ACE(TM)

ACE is an avionics system used for debriefing air combat missions and is based on data recordings from digital and analog communication channels on the aircraft on top of the aircraft's video recorder. The system converts the data into digital form and installs it on the video channels of the aircraft. On the ground, the data is utilized by our ground debriefing station to generate 3-D graphic displays that portray all the aircraft's maneuvers during operational and training missions. The graphic display is fully synchronized with the heads-up displays recorded on each participant's video recorder. The Israeli Air Force (F-16, A/B) and two other air forces (F-5) currently utilize the ACE system.

The ability to provide debriefing of air combat maneuvers may also be implemented as an additional application to our FACE system. The Royal Netherlands Air Force is utilizing this capability of the FACE system to debrief its aircrews.

Our latest enhancement of the ACE concept resulted in a contract with the Israeli Ministry of Defense and the Israeli Air Force in the first quarter of 2002. Under the contract we upgrade all of the existing A-4 aircraft of the Israeli Air Force in order to provide these aircraft with our advanced ACE debriefing capabilities. The absence of inertial navigation data onboard the A-4 aircraft led us to integrate a stand alone internal navigation system, or INS, and a global positioning system, or GPS, on board the aircraft. We believe this will open the market for non MIL-STD 1553 Max Bus equipped aircraft to utilize the ACE. In 2003, we initiated a marketing campaign to promote these new capabilities of the ACE. We believe that this A-4 program places us in a unique position that will result in all the advanced Israeli Air Force trainers being equipped with our debriefing solutions.

Ground Debriefing Station

Since 1999 we have offered operational ground debriefing stations that complement our airborne systems. The operational ground debriefing station is

installed on a PC and operates in a Windows NT/2000 environment. The operational ground debriefing station, which was designed by our employees (Israeli Air Force F-16 and F-15 pilots in reserve service), is user-friendly with a graphic display that is fully synchronized with the heads-up displays recorded on each participant's video recorder. For users that operate more than one ground debriefing station, our product provides a connection between other ground-debriefing stations, through a LAN or WAN, to allow data sharing and mutual debriefing. The Israeli Air Force and two other air forces have purchased ground debriefing systems for their F-16 A/B and A-4 fleets.

Digital Video Based Training Systems

Recent development in digital video recording systems and the significant reduction in size and cost of solid state memory hardware in recent years make solid state digital video recording systems a superior solution for airborne applications. These systems are beginning to penetrate the aviation industry both in new aircraft such as the F-16I and in the retrofit market. We have identified this trend and developed our advanced digital video-based debriefing capabilities for the Peace Marble V Program, or PM-V Program relating to the new F-16's of the Israeli Air Force, or IAF. This new solution provides significantly improved debriefing capabilities as well as extensive networking features for the ground infrastructure. In March 2004, we delivered the first digital ground debriefing stations to the IAF, and they are currently being used with the IAF's new F-16I aircraft.

Following the PM-V Program, we delivered two additional systems to Lockheed Martin Aerospace for use in integration and flight testing in the fourth quarter of 2002. We also signed a contract to develop and deliver a complete digital video based debriefing system for the new F-16's purchased by the Chilean Air Force. As a result of the development work that was accomplished in connection with the Peace Marble V Program, we are supplying the Chilean Air Force with a digital video recorder for each F-16 aircraft that they purchase as well as an advanced digital video ground debriefing station. This station will be connected to our previously delivered F-5 ground debriefing station creating a common network debriefing solution for both front-line aircraft.

Advance Fleet Maintenance Management Solutions

Our fleet maintenance management solutions are based on our existing programs and products developed and supplied during the past two years. These programs include both airborne equipment that collect and store the relevant data (such as FACE or DAS) and ground support software packages (such as PERFORMS) that provide the infrastructure for efficient data logging and analysis to support fleet maintenance management.

Fatigue Analysis and Autonomous Air Combat Evaluation System - FACE(TM)

The FACE system is an avionics system designed to acquire, process and record data from various aircraft systems and from strain gauges (sensors) affixed to an aircraft's structure. This data is used to streamline and manage the ongoing maintenance of an aircraft and its

systems. The FACE system communicates with a squadron's ground support logistic station, enabling downloading of data from an aircraft, managing ongoing maintenance, creating and modifying the set-up configuration files and determining which data will be recorded, as well as providing for other applications.

The FACE system is capable of communicating with, and transferring in real time, safety data it has recorded to a voice and data recorder, which is a crash survival unit known as a "black box" manufactured by Smiths Electronic Systems. We are currently upgrading the FACE systems that we supplied to the Royal Netherlands Air Force F-16 for its aircraft during the years 1996 to 1999 and are supplying FACE systems for the F-16 aircraft used by the Belgian Air Force and the Portuguese Air Force.

Data Acquisition System - DAS

The DAS is an advanced avionics data acquisition system designed to acquire, process and record data from various aircraft systems. We and Smiths Electronic Systems jointly developed and marketed the DAS for the new F-16I aircraft of the Israeli Air Force. DAS consists of two sub-systems, a data acquisition unit, or DAU, and an advanced crash survival memory unit, or ACSMU. The DAU is connected to numerous data systems and data channels in the aircraft and acquires, processes and records data, mostly for maintenance purposes. The ACSMU is a "black box" capable of recording digital data and digitized audio transferred through the DAU. DAS is a form fit replacement to the CSFDR system, which is currently installed on most F-16 aircraft worldwide. DAS has been offered as a substitute in various projects that require a flight data recorder with advanced capabilities and growth potential. During 2003, we received three different orders for DAS units.

PERFORMS

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

The analysis includes fatigue monitoring, engine usage monitoring and other applications that may be added, as required, by different users. The recorded data is downloaded to the station and stored in a commercial off the shelf database that enables "plug-in" applications to access the data, manipulate and analyze it and provide many maintenance management applications. The program is managed by Lockheed Martin Aerospace and is supplied to users in repeated software "builds" delivered every 12 months begInING in April 2003. Under the agreement, we were granted a non-exclusive license to use the developed software in support of our FACE and DAS products to supply the application to its flight data recorders customers.

Integrated Weapons Management Systems

In the early 1980s we started to develop, manufacture and sell an armament interface unit which controls the various weapon stations of an aircraft based on commands from the main on-board computer. The armament interface unit was designed for use by Israeli Aircraft Industries for its worldwide upgrade programs. Later versions of the system can be installed in

attack helicopters as well as in fighter aircraft. We are now in the process of supplying a derivative of the system to Israel Aircraft Industries for an F-5 upgrade program in Spain and are currently proposing the system for many other applications in both Israel and foreign customers.

In the avionics area we develop, manufacture and sell armament interface units which control the various weapon stations of an aircraft based on commands from the main on-board computer. The armament interface unit was designed for use by Israeli Aircraft Industries for its upgrade programs worldwide. This avionics system may be installed in attack helicopters as well as in fighter aircraft. Future sales of armament interface units are dependent upon the success of the Israeli Aircraft Industries upgrade programs

We also provide complete armament testing solutions for aircraft using our and others' weapons management systems. The test unit is used to verify the serviceability of the armament management system during periodic maintenance or before sophisticated weapons are installed.

Data Acquisition and Management Systems

As a result of our developments efforts for the PM-V Program, we have added a new family of Solid State Recorders to our family of products. This family of products provide scalable versions of sophisticated, fast and very effective recorders, suitable for severe environmental conditions, that can provide solutions to numerous data collection, storage and management needs.

The capabilities of these products include a large amount of data storage, very fast read and write capability and utilization of solid state memory to enable it to function onboard military aircraft.

Unmanned Air Vehicle Avionics

We have identified the Unmanned Air Vehicle, or UAV, avionics market as having significant potential. We began our marketing activities in this market in 2002. These activities resulted in two products aimed at the UAV market that are now under development.

Currently we operate in the UAV avionics market as subcontractors, mainly for Israel Aircraft Industries. We believe that our continued activities in this market will enable us to increase our involvement in the production process and to offer additional products and additional functions which will extend our product capabilities.

Automatic Testing Solutions

We have attempted to position ourselves, domestically as well as internationally, as a company that provides turnkey services for all test-solutions purposes for both commercial and military aviation. We offer our off-the-shelf automated test equipment, or ATE, platforms, test

solutions and software environments that enable the implementation and development of test programs and test solutions. As such, we build the hardware and develop, produce and update the software relative to these solutions. We offer these for sale or lease and offer post-sale support programs.

We are currently seeing increased interest in the automated testing solutions, especially from FAA certified maintenance facilities. This trend is a

direct result of the slow recovery of the commercial aviation business and of the increasing need in maintenance services due to expiration of warranties on aircraft purchased approximately 5 years ago.

CATS(R)

Commercial Aviation Test Stations, or CATS(R), is our off-the-shelf modular ATE platform. It offers a family of multi-purpose, computerized Automatic Test Equipment that meet the specific needs of avionics manufacturers, airlines and third party maintenance companies to test and repair the electronic units of commercial aircraft. CATS(R) includes tools for testing, troubleshooting, and performing diagnostic procedures on a variety of units in existing commercial aircraft, replacing or augmenting testing stations of airplane manufacturers or OEM's and automating manual test procedures.

The CATS(R) system design is based on a modular and open architecture that enables scalable test solutions while maintaining a standardized system. This design provides the flexibility that allows for system configuration tailoring to any maintenance requirement and thus, significantly reducing its cost.

We have developed a library of over 200 Test Program Sets, or TPSs, that include the test programs and test unit adapters for testing a large variety of line replaceable units that range from Boeing 747 aircraft classic analog units to sophisticated digital units for the Boeing 777 aircraft. Each TPS is specifically designed to test a particular airborne electronic unit. Our TPSs can be duplicated at a relatively low cost for use in similar applications by different customers. We offer the CATS(R) with its test environment in order to enable our customers to develop their own new test programs. In this way we hope to enhance our TPS library.

Mini-CATS(R)

The Mini-CATS(R) is another of our off-the-shelf modular ATE platforms. It is a state-of-the-art PC-based, general purpose and low-cost ATE. Like the CATS(R), it is used to test and repair airborne electronic units. But the Mini-CATS(R) is suitable for low to medium complexity units, with a declared goal of providing maintenance at a very low cost.

The Mini-CATS(R) provides potential customers with an independent test solution that may be purchased as a stand-alone unit or as part of a package with a full-size CATS(R). Existing customers may use the Mini-CATS(R) as an easy add-on to an existing full-size CATS(R), adding both new capabilities as well as test capacity by freeing up use of the full-size CATS(R) and testing simpler units or high volume units. Both systems share the same user-interface, thus decreasing training and maintenance costs.

The Mini-CATS(R) includes tools for testing and troubleshooting a variety of units of various manufacturers. The system includes inherent user-friendly software for generating new test program sets and updating existing test program sets. The Mini-CATS(R) enables scalable and modular customization adjusting to customers needs. Our first test solution development on the Mini-CATS(R) was for Smiths Electronic Systems Group's Control and Display Unit mounted on the Boeing 737NG aircraft.

We have developed and customized a comprehensive agile test environment, based on Microsoft Windows NT(R) and the National Instruments TestStand(TM).

This agile environment (e-CATS(R)) may be applied to any type of ATE and test solution and has specific technical advantages by providing full connectivity for the ATE to any external data-base/service, advanced TPS development tools and obsolescence management of measurement and stimulus equipment on the ATE. To date, we have not sold any Mini-CATS(R) and cannot guarantee that any future sales will be made.

Manufacturing Services

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

Test and Repair Stations

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

Sales and Marketing

Sales and Marketing Strategy

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

- Maintaining our business focus on avionics for the military market and our family of testing solutions for the commercial and military markets.
- Expanding our product line by adding new products and applications to our existing products by using our current development programs as the basis for new developments.
- Expanding our customer base by including our products in solutions and integrated systems. This approach was successful both in Chile where, in 2002, we were awarded a contract to

provide a complete debriefing solution for the F-16 aircraft purchased by the Chilean Air Force, and with the IAF, to whom we supply complete weapon delivery and navigation system for the A-4 aircraft.

- Establishing marketing channels with system integrators and major aircraft manufacturers such as The Boeing Company, Lockheed Martin Aerospace, Smiths Aerospace, Israel Aircraft Industries and RAFAEL.
- Expanding large potential markets, especially in the military and the unmanned combat air vehicle areas, and developing new marketing channels aimed directly at these customers.

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

Lockheed Martin Aerospace. Our sales of avionics products focus mainly on the F-16 aircraft manufactured by Lockheed Martin Aerospace, the most popular fighter aircraft in the Western world today. In February 1999, we signed a memorandum of understanding with Lockheed Martin pursuant to which we will provide certain avionics systems for the F-16 aircraft under the PM-V Program. In September 1999, the U.S. and the State of Israel signed a letter of acceptance pursuant to which the U.S. will provide the Israeli Air Force with 50 F-16I aircraft and an option for additional 52 aircraft, which was exercised on June 2001 for a total of 102 F-16I aircraft. In cooperation with Smiths Electronic Systems, we are developing and supplying the data acquisition system that includes the advanced data acquisition unit and an enhanced crash survivable memory unit, which will be manufactured in our Beit She'an facility. We are currently negotiating with Lockheed Martin with respect to the development of additional capabilities of this system for different applications.

In addition, in March 2001 we signed an agreement with the Aircraft Structural Integrity Program Group of Lockheed Martin pursuant to which we are assisting in the development of a fatigue analysis system based on a PC computer for analyzing structural fatigue of the F-16 aircraft. As the main subcontractor, our principal task is to develop the software for the fatigue analysis system. The fatigue analysis system will utilize data collected from the data acquisition unit and our FACE system, as well as other systems used by air forces operating F-16 aircraft. This five year development program will end in March 2006.

Smiths Aerospace Electronic Systems. In February 1999, we entered into an agreement with Smiths Aerospace Electronic Systems that outlines joint marketing activities for our FACE system and Smiths Aerospace Electronic Systems' voice and data recorder for F-16 A/B aircraft. Smiths Aerospace Electronic Systems is a worldwide leader in avionics systems for fighter and commercial aircraft. The two systems successfully passed flight tests conducted on the Royal Netherlands Air Force's F-16 aircraft by Lockheed Martin and the Royal Netherlands Air Force. The FACE system and the voice and data recorder complement each other and are intended to replace outdated data recording systems, mechanical strain recorders and flight load recorders. No sales under this agreement have been made to date.

In June 2000, we signed a memorandum of understanding with Smiths Aerospace Electronic Systems pursuant to which the parties will establish a team for worldwide marketing, developing and manufacturing of the data acquisition system and its associated ground support that is intended to grow into an infrastructure for recording, processing and managing all data types available on board the aircraft. No sales of the systems have been made to date under this agreement. We cannot assure you that we will successfully negotiate a definitive agreement with a customer nor can we provide at present any forecast that the agreement with Smiths Aerospace Electronic Systems will result in future sales of avionics systems.

In October 2003 we signed a teaming agreement with Smiths Aerospace

Electronic Systems. The teaming agreement establishes cooperation in connection with the products developed jointly by Smiths Aerospace Electronic Systems and us for the PM-V Program and their derivatives. In addition, the agreement details commitments made by Smiths Aerospace Electronic Systems to purchase production services from us in the coming years.

Smiths Aerospace Electronic Systems was our principal customer in 2003 and we expect that it will continue to be one of our principal customers in 2004. In addition to the PM-V cooperation with Smiths, we are currently supplying the Royal Netherlands Air Force with an integration package for our FACE system and Smiths' VADR for the its F-16 MLU fleet. A similar package is also being supplied to the Portuguese Air Force.

Israel Aircraft Industries. IAI was our fourth largest customer in 2003, accounting for more than 12% of our total annual revenues. We are actively supplying avionics and test equipment to four different divisions of IAI. We have identified the Israeli government-owned aerospace industries as a potential customers and cooperation entities. In particular the Lahav and Malat divisions of IAI, major aircraft integrators, require our services as avionics and test equipment providers.

Rafael Armament Development Authority Ltd. Rafael was one of our largest Israeli customers in 2003. Our sales to Rafael during 2003 provided mainly test equipment and build to print services. The addition of the Solid State Recording family of products to the products we supply to Rafael adds our own developed products to these sales. We expect that the SSR will lead Rafael to be one of our significant customers.

Marketing

Our Chairman and President, Herzle Bodinger, our CEO, Adar Azancot, and our V.P Business Development, Zvi Alon, lead our marketing efforts. We currently employ two other persons in marketing our core business products and plan to employ an additional person. Our engineering department supports our marketing staff with respect to product pricing and technical demonstrations. In addition, we have sales consultants, agents and representatives in Europe, South America, China and India who receive commissions for sales effected through them.

The Israeli Ministry of Defense has historically supported and continues to support our marketing efforts through its Export and Defense Assistance division, or SIBAT, through various projects for the Israeli Defense Forces and its related divisions. The Israeli Ministry of Industry and Commerce supports our marketing efforts via its Industrial Cooperation Authority through

the exploitation of "offset commitments" by Lockheed Martin Aerospace and The Boeing Company to the State of Israel. Such future assistance is not guaranteed.

Principal Customers

Generally, we complete a few transactions each year, each in an amount comprising approximately 10% of our revenues for such year. As a result, each year a significant portion of our revenues is derived from a small number of customers. The following table sets forth our principal customers for the years 2002 and 2003:

	2002	2003

Smiths Electronic Systems.....	34%	22%
The Boeing Company.....	19%	14%
Israeli Ministry of Defense.....	3%	11%
Israel Aviation Industries.....	6%	12%
Portuguese Air Force.....	4%	19%

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

Like many companies deriving a substantial portion of their revenues from government contracts, we are subject to business risks, including changes in governmental appropriations and changes in national defense policies and priorities. Although many of the programs in which we participate as a contractor or subcontractor may extend for several years, our business is dependent upon annual appropriations and funding of new and existing contracts. Most of the contracts are subject to termination for the convenience of the customer, pursuant to which the customer pays only for reimbursement of costs incurred and the applicable profit on work performed. We cannot assure you that the Israeli Government or any other government will continue to fund the purchase of our products over the long term.

Competition

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

Export Policy

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

Fixed Price Contracts

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

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

Proprietary Information

We were granted a patent for our ACE system in both Israel and the United States (No. 5467274.) Nevertheless, we generally do not consider patent protection significant to our current operations and rely upon a combination of security devices, copyrights, trademarks, trade secret laws and contractual restrictions to protect our rights in our products. Our policy is to require employees and consultants to execute confidentiality agreements upon the commencement of their relationships with us. These measures may not be adequate to protect our technology from third-party infringement, and our competitors might independently develop technologies that are substantially equivalent or superior to ours. Additionally, our products may be sold in foreign countries that provide less protection for intellectual property rights than that provided under U.S. or Israeli laws.

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

Manufacturing and Supply

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

We stress quality control in our product realization process. Commencing with customer requirements and expectations via raw material inspection through completion, specifications are repeatedly checked. We maintain a quality assurance team that participates in every stage of the design and manufacture of

our products. Our quality management standards are certified by the Standards Institute of Israel, or SII, pursuant to ISO 9001 for hardware design and production and ISO 9000.3 for software, both since 1995. SII performs quality system audits twice a year and various customers perform audits four to six times a year. In April 2001, SII certified our Environmental Management System pursuant to ISO 14001. Our Quality Management System is being revised to comply with ISO 9001:2000. This process is expected to be concluded in June 2003.

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

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

C. ORGANIZATIONAL STRUCTURE

We had one active subsidiary in 2003, Beijing Huarui Aircraft Components Maintenance and Services Co., an 80% owned subsidiary based in China that is engaged in aircraft repair services.

D. PROPERTY, PLANTS AND EQUIPMENT

Facilities

We own a 30,000 square feet building in Beit-She'an, Israel. The building, which includes manufacturing facilities, warehouse space and a portion of our development facilities, is situated on land leased from the Israel Land Authority for a period of 49 years until 2034. The plant has sufficient capacity to meet our current requirements. If volume was to increase

significantly, we would be able to increase the number of workers or shifts at the plant, or use more subcontractors.

Our executive offices and research and development facilities are located in a 9,000 square foot office facility in Netanya, Israel. The lease for this facility expires in January 2005. We are currently negotiating the renewal of this lease until April 2006, with an option to renew it again, until April 2008.

Our Chinese subsidiary, CACS, conducts its business in an approximately 16,000 square foot facility in Beijing that includes offices and test and repair facilities. The land for this facility was leased by Beijing Tianzu Forestry Company or Tianzu, the minority shareholder in CACS, from the Chinese government for 30 years. Under a joint venture agreement, and in consideration for its equity investment in CACS, Tianzu granted CACS usage rights in the land,

constructed the buildings and granted CACS the ownership of these buildings. However, the transfer of the title to the land and the buildings has not been completed, which may prevent the disposition of these assets should CACS desire to do so. Although Tianzu is legally obligated to complete such transfer of title to the land and the buildings, we can not guarantee that such transfer will be completed, or that we will not be required to initiate litigation in order to enforce our rights to receive title to the land and buildings.

The aggregate annual rent for our offices in Israel and China was approximately $133,000 in 2003.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. OPERATING RESULTS

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

Overview

We develop, manufacture and sell automated test equipment and avionics products for military and commercial use mainly in Israel, Europe and the United States. Until December 31, 2001 we also sold aircraft spare parts through our subsidiary, Jetborne International, but this business was discontinued following the sale of our holdings in Jetborne. We also provide test and repair services using our CATS(R) testers and test program sets through our Chinese subsidiary, CACS. In addition, we provide manufacturing services to third parties engaged mainly in the avionics market.

In March 2002, we sold, effective December 31, 2001, our 75% equity interest in Jetborne to ILI Aviation Ltd., a private company registered under the laws of the Marshall Islands. ILI undertook to cause Jetborne to repay us all outstanding inter-company loan balances plus interest and additional royalties whereby the repayment will be made in accordance with a schedule based on a percentage of actual sales of Jetborne's inventory on hand on the effective date of the agreement. All payments due to us under the agreement must be paid no later than

the tenth anniversary of the agreement. Based on our assessment of the collectibility of this debt we recorded an allowance for the full balance due to us under the agreement.

Critical Accounting Policies

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

The significant accounting policies listed in Note 2 of our consolidated financial statements that we believe are the most critical to aid in fully

understanding and evaluating our financial condition and results of our operations under generally accepted accounting principles are discussed below.

Intangible Assets. Costs of producing our TPS software library, which is integrated with our test station, incurred subsequent to achieving technological feasibility, were capitalized according to FASB No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" and are amortized over the estimated useful life of the product. We assess the recoverability of these intangible assets at each balance sheet date by determining whether unamortized capitalized costs do not exceed the net realizable value of the software. Net realizable value is the estimated future gross revenues from a product reduced by the estimated future costs of disposing of that product, including costs of performing maintenance and customer support required to satisfy our obligations set forth at the time of sale. The use of different assumptions with respect to the expected cash flows from our assets and other economic variables, primarily the discount rate, may lead to different conclusions regarding the recoverability of our assets' carrying values and to the potential need to record an impairment loss for our intangible assets.

Impairment of Long-Lived Assets. We are required to assess the impairment of long-lived assets on an annual basis, and potentially more frequently when events or changes in circumstances indicate that the carrying value may not be recoverable in accordance with Statement of Financial Accounting Standards, ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." We assess the impairment of our assets based on a number of factors, including any significant changes in the manner of our use of the respective assets or the strategy of our overall business and significant negative industry or economic trends. Upon determination that the carrying value of a long-lived asset may not be recoverable, based upon a comparison of fair value to the carrying amount of the asset, an impairment charge is recorded. We measure fair value based on the projected future undiscounted cash flows expected to be generated by the respective asset. Under different assumptions with respect to the recoverability of our long-lived assets, our determination may be different, which may negatively affect our financial position and results of operations. As of December 31, 2003, no impairment was required.

Share-Based Compensation. We account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board ("APB") opinion No. 25, "Accounting

for Stock Issues to Employees," and related interpretations. Under APB 25, compensation cost is measured as the excess, if any, of the closing market price of our stock at the date of grant over the exercise price of the option granted. We recognize compensation cost for stock options, if any, ratably over the vesting period. We account for warrants issued to non-employees in accordance with the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation". We use the Black- Scholes option pricing model to value warrants granted to non-employees.

Revenue Recognition. Our revenues are derived primarily from sales of automated test equipment and avionics products. Revenues from sales of automated test equipment and avionics products are recognized upon delivery of merchandise or performance of services. Revenues from sales of other products are generally recognized upon shipment of the product. Revenues from services are recognized upon performance of the services. Revenues from long-term fixed price contracts are recognized by the percentage-of-completion method. We apply this method when the total of the costs of the contract can reasonably be estimated. Revenues

ascribed to each period represent costs incurred during the period, with the addition of estimated earnings accrued, based on the extent of progress towards completion during the period. The percentage-of-completion is determined for each contract at the rate that costs incurred to date bear to the total estimated cost to be incurred over the duration of each contract. With regard to contracts on which a loss is anticipated, a provision is made for the entire amount of the estimated loss. Contracts are considered to be 100% complete when the customer accepts the project and when the project is delivered, or when the project complies with performance specifications, depending upon the specific situation. Revenues from test and repair services are recognized upon performance of the maintenance services.

Revenues from certain arrangements may include multiple elements within a single contract. Our accounting policy complies with the revenue determination requirements set forth in EITF 00-21, relating to the separation of multiple deliverables into individual accounting units with determinable fair values. Our arrangements are accounted for as one unit of accounting.

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

Fair Value of Warrants. In September 2003, we finalized an agreement with Bank Hapoalim B.M. and Bank Leumi Le Israel B.M., or our Banks, to restructure $3,451,000 of our debt to them. Pursuant to the agreement, we paid the Banks $1,100,000 on account of our debt to them and they forgave $1,100,000 in debt and agreed to accept warrants to purchase 3,781,995 of our ordinary shares, exercisable at par value per share, to purchase ordinary shares in lieu of $1,251,000 of debt. This transaction was recorded in accordance with FASB No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings." The warrants issued to the Banks were recorded at fair value using the Black and Scholes pricing model, since we do

not believe that the market price of an ordinary share on Nasdaq on the date of consummation reflects fair value. The fair value of the warrants was based on the value of an ordinary share at the consummation date of the transaction, based on a valuation of the warrants prepared by an external valuation expert. The difference between the consideration paid to the Banks and the carrying amount of the debt was recognized as a gain on restructuring of debt, net of issuance expenses.

Significant Expenses

Cost of Revenues. Cost of revenues consists primarily of manufacturing costs, depreciation of fixed assets, software development costs, impairment losses on long-lived assets and amortization of capitalized software.

Research and Development Expenses. Research and development expenses consist primarily of salaries of employees and subcontractors engaged in on-going research and development activities and other related expenses. Research and development expenses are expensed as incurred.

Marketing, Selling, General and Administrative Expenses. Marketing and Selling expenses consist primarily of expenses for sales and marketing personnel, sales commissions, marketing activities, public relations, promotional materials, travel expenses and trade show exhibit expenses. General and administrative expenses consist primarily of salaries and related expenses for executive, accounting, administrative personnel, professional fees, provisions for doubtful accounts, and other general corporate expenses.

Financial Income (Expenses), Net. Financial expenses consist of interest and bank expenses and currency remeasurement losses. Financial income consists of interest on cash and cash equivalent balances, currency remeasurement gains and gain on restructuring of debt.

Other Expenses, Net. Other expenses, net relate primarily to items of income or expenses outside our ordinary course of business.

Year Ended December 31, 2003 Compared With Year Ended December 31, 2002

Revenues. Our revenues increased 18% to $12.3 million in 2003 from $10.4 million in 2002. The increase in our revenues is primarily attributable to the increase of revenues from the sale of GDS and DAS to Smiths Aerospace Electronic Systems for the PM-V Program and sale of FACE systems to the Portuguese Air Force. We expect that this growth rate will continue in 2004 and that the growth will be generated primarily from sales of our traditional products.

Cost of Revenues. Cost of revenues increased 4% to $9.6 million in 2003 from $9.2 million in 2002 mainly due to increased revenues and impairment losses recognized on some of our long-lived assets. In 2004 we expect that our cost of revenue will increase due to the increase in revenue but will not increase materially as a percentage of revenues.

Gross Profit. Our gross profit increased 132% to approximately $2.7 million in 2003 from $1.2 million in 2002. Our profit margin increased to 22% in 2003 from 11% in 2002. The improved margins reflects our reaching a sales level that provides for better utilization of our

fixed overhead costs. Our margins should improve further with better utilization of our manufacturing facilities.

Research and Development Expenses. In 2003 we did not incur any research and development expenses as compared to 2002 when we expended $122,000 for research and development. We made a strategic decision not to engage in internal research and development activities but, rather, enter into development projects through customers' orders. In 2004 we expect that we will develop new products through customer orders and will not use internal funded research.

Marketing, Selling, General and Administrative Expenses. Marketing, selling, general and administrative expenses decreased 13% to $2.7 million in 2003 from $3.1 million in 2002 mainly due to cost saving measures taken by us to reduce our overhead. We expect that our total marketing, selling, general and administrative expenses will increase slightly in 2004. Although we are continuing our costs savings measures, increasing ales efforts in our current

and new markets will increase our marketing and selling expenses .

Financial Income (Expenses), Net. Our financial income, net was $708,000 in 2003 and our financial expenses, net was $364,000 in 2002. Our financial income in 2003 was primarily attributable to an approximate $1 million gain on our restructuring of debt with the Banks.

Year Ended December 31, 2002 Compared With Year Ended December 31, 2001

Revenues. Our revenues increased 25.3% to $10.4 million in 2002 from $8.3 million in 2001. The increase in our revenues is primarily attributable to the increase of revenues from the sale of GDS and DAS to Smiths Aerospace Electronic Systems for the Peace Marble V Program and an increase in "build to print" manufacturing activities. Revenues from sale of aircraft parts were reduced to zero due to our sale of Jetborne in 2001.

Cost of Revenues. Cost of revenues increased 24% to $9.2 million in 2002 from $7.4 million in 2001 mainly due to increased revenues and impairment losses recognized on some of our long-lived assets. Cost of revenues from sale of aircraft parts were reduced to zero due to our sale of Jetborne in 2001.

Gross Profit. Our gross profit increased 27% to $1.2 million in 2002 from $0.9 million in 2001. Although our profit margin remained approximately the same (11%) in both our results in 2002 were achieved despite changes arising from the impairment of long-lived assets.

Research and Development Expenses. Research and development costs decreased 77% to $122,000 in 2002 from $534,000 in 2001, mainly due to our strategic decision to not engage in internal research and development activities but, rather, enter into development projects with our customers.

Marketing, Selling, General and Administrative Expenses. Marketing, selling, general and administrative expenses decreased 14% to $3.1 million in 2002 from $3.6 million in 2001 due to cost saving measures taken by us to reduce our overhead.

Other Expenses, Net. Other expenses of approximately $290,000 in 2002 is related to the allowance recorded in connection with an amount owed to us by Jetborne, our former subsidiary.

Operating Loss from Continuing Operations. As a result of the foregoing, our operating loss decreased 37% to $2 million in 2002 from $3.2 million in 2001.

Financing Expenses, Net. Net financing expenses increased 73% to $364,000 in 2002 from $210,000 in 2001, primarily due to an increase in interest expense due to cash shortages during the year that were financed through loans and short term credit facilities bearing higher interest rates.

Conditions in Israel

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. Accordingly, we are directly affected by political, economic and military conditions in Israel. Specifically, we could be adversely

affected by any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, and a significant downturn in the economic or financial condition of Israel.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Since September 2000, there has been a marked increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza. There is no indication as to how long the current hostilities will last or whether there will be any further escalation. Any further escalation in these hostilities or any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. Furthermore, there are a number of countries that restrict business with Israel or Israeli companies. Restrictive laws or policies of those countries directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

In addition, some of our executive officers and employees in Israel are obligated to perform up to 36 days, depending on rank and position, of military reserve duty annually and are subject to being called for active duty under emergency circumstances. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

To date, no executive officer or key employee has been recruited for military service for any significant time period. Any further deterioration of the hostilities between Israel and the Palestinian Authority into a full-scale conflict might require more significant military reserve service by some of our employees, which may have a material adverse effect on our business.

Economic Conditions

In recent years Israel has been going through a period of recession in economic activity, resulting in low growth rates and growing unemployment. Our operations could be adversely affected if the economic conditions in Israel continue to deteriorate. In addition, due to significant economic measures proposed by the Israeli Government, there have been several general strikes and work stoppages in 2003 and 2004, affecting all banks, airports and ports. These strikes have had an adverse effect on the Israeli economy and on business, including our ability to deliver products to our customers. Following the passing by the Israeli Parliament of laws to implement the economic measures, the Israeli trade unions have threatened further strikes or work-stoppages, and these may have a material adverse effect on the Israeli economy and on us.

Trade Relations

Israel is a member of the United Nations, the International Monetary

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

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

Corporate Tax Rate

Israeli companies are generally subject to income tax at the corporate tax rate of 36% of taxable income. However, an investment program at our facility in Beit-Shean has been granted "approved enterprise" status under the Law for Encouragement of Capital Investments, 1959, and consequently we are eligible for some tax benefits. The portion of our income derived from the approved enterprise program will be tax-exempt for a period of two years commencing in the first year in which it generates taxable income and will be subject, for the following period of five to eight years, to a reduced corporate tax of 15%-20% (the rate will depend upon the percentage of non-Israeli holders of our ordinary shares). However, these benefits will not be

available to us with respect to any income derived from our non-Israeli subsidiaries. The above mentioned benefit program will expire in 2004.

As of December 31, 2003, our net operating loss carry-forwards for Israeli tax purposes were approximately $43 million.

Impact of Currency Fluctuation and of Inflation

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

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

such devaluation:

Year ended December 31,	Israeli Consumer Price index	Israeli inflation rate %	Israeli devaluation rate %	Israeli inflation adjusted for devaluation %
1999	100	1.3	(0.2)	1.5
2000	100	0	(2.7)	2.8
2001	101.4	1.4	9.3	(7.8)
2002	108.2	6.8	7.3	0.7
2003	106.14	(1.9)	(7.6)	(6.1)

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

B. LIQUIDITY AND CAPITAL RESOURCES

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

As a result of continuing losses during the period 1999 through 2002 that amounted to $58.5 million, we were forced to incur substantive debt and issue equity securities. During the four years ended December 31, 2003, we relied predominantly on Howard Yeung and our other

principal shareholders, and to a lesser extent on new investors to provide us with working capital. During this period they provided us with $13.1 million in equity capital, convertible debt and loans.

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

At an extraordinary meeting of shareholders held on June 9, 2002, our shareholders approved the terms of a purchase agreement between us and certain investors, pursuant to which such investors purchased 1,938,775 of our ordinary shares at a price of $0.49 per share, which was equal to 70% of the average closing price of the ordinary shares for the ten (10) trading days prior to June 9, 2002. In addition, pursuant to the approval of our shareholders, we issued to such investors warrants to purchase 4,302,041 of our ordinary shares. Such warrants have a term of five years and are exercisable during the first 36

months after issuance at an exercise price of $2.00 per share, and during the subsequent 24 month period, at an exercise price which will be equal to the higher of: (i) $2.00 per share or (ii) 50% of the average closing price during the ten (10) trading days prior to an exercise date. The warrants contain certain anti-dilution provisions that could reduce the exercise price of the warrants in the event that we issue securities at a price below the exercise prices of the warrants our shareholders also approved the conversion of the $1,350,000 of loans granted by Mr. Yeung, into 2,755,102 of our ordinary shares at a price of $0.49 per share, which was equal to 70% of the average closing price of our ordinary shares for the ten trading days prior to the date of shareholder approval. As part of the transaction, we issued to Mr. Yeung on June 30, 2002 warrants to purchase 8,265,306 ordinary shares. Such warrants will be outstanding for five years and will be exercisable during the first 36 months at an exercise price of $2.00 per share, and during the subsequent 24 month period, at an exercise price which shall be equal to the higher of: (i) $2.00 per share or (ii) 50% of the average closing price of our ordinary shares during the ten (10) trading days prior to the exercise date.

Under the terms of the purchase agreements, we also agreed to provide the investors and Mr. Yeung with certain registration rights.

On June 22, 2003 we signed a memorandum of agreement with our Banks, which agreement was approved by our shareholders at an extraordinary general meeting of shareholders that was held on July 22, 2003. Pursuant to the agreement, or the Agreement, that was finalized on September 24, 2003, we restructured $3,451,000 of our outstanding debt to the Banks. We repaid $1,100,000 on account of our debt the Banks, and the Banks forgave $1,100,000 of debt and received warrants to purchase 3,781,995 of our ordinary shares, at an exercise price that is equal to the nominal (par) value of our shares, in lieu of $1,251,000 of our debt. These warrants may not be exercised for a period of 21 months unless transferred pursuant to the call or put options described below. These warrants expire on March 24, 2006. The Banks have also agreed to grant us an additional short-term line of credit of $500,000 to finance our cash flow requirements during 2003. As part of the Agreement our controlling shareholder Mr. Howard P. L. Yeung has agreed to grant the Banks a put option allowing the Banks to require him to purchase the above warrants for the consideration of $1,251,000, exercisable within a period of 45 days commencing on March 24, 2005 and the Banks granted Mr. Yeung a call option allowing him to require the Banks, during a period of 18 months, commencing as of September 24, 2003, and in the event that the Banks will not exercise their put option, during additional 90

days period commencing as of May 9, 2005, to sell him such warrants at a price that is not lower than $1,251,000 and not higher then $1,770,165, pending upon the average close price of the shares during the last 90 business days prior to such exercise. We have also agreed to grant the Banks warrants to purchase an additional 1,100,000 ordinary shares at an exercise price of $2.00 per share, exercisable for 5 years, commencing as of September 24, 2003.

As of December 31, 2003, we had a short-term loan of approximately $1,411,000 from Bank Leumi bearing interest at a rate of Libor plus 4%. Subsequent to our balance sheet date, Bank Leumi agreed to extend the payment terms of this loan and, as a result, approximately $ 1.2 million of the loan was reclassified as long-term debt. We also had a credit facility with Bank Leumi., which provides for borrowings of up to NIS 1,314,000 (approximately $300,000) as of December 31, 2003) bearing interest of prime plus 3%, of which NIS 867,000 ($198,000) was drawn as of December 31, 2003. As of December 31, 2003, we also

had a credit facility with Bank Hapoalim of NIS 4,326,000 (approximately $988,000), bearing interest of Prime plus 1%, under which NIS 3,213,000 (approximately $734,000) was outstanding as of December 31, 2003. The borrowings from the Banks are secured by a first priority floating charge on all our assets and by a fixed charge on goodwill (intangible assets), unpaid share capital and insurance rights (rights to proceeds on insured assets in the event of damage). Our agreements with the Banks prohibit us from selling or otherwise transferring any assets except in the ordinary course of business, from placing a lien on our assets without the Banks' consent and from declaring dividends to our shareholders. In addition, our debt to the Israeli Tax Authority is secured by a first priority fixed charge on our fixed assets in Beit-Shean facility.

We had capital expenditures of $49,000 in 2003 and $85,000 in 2002. We currently do not have any significant capital spending or purchase commitments. The decrease in capital expenditures in 2003 is primarily attributable to the decision to lease computers, other equipment and vehicles, rather than purchase them, and to decreased in house construction of machinery and equipment for our own use.

Net cash generated from operating activities was $1,021,000 in 2003. This was attributable primarily to our net income of $758,000.

Net cash used in operating activities was $425,000 in 2002. This was attributable primarily to our net loss of $2.5 million, an increase in trade receivables of approximately $1 million, a decrease in deferred revenues of approximately $0.6 million, which was offset in part by depreciation and amortization of $2.4 million, a decrease in inventories of approximately $500,000 and a decrease in costs and estimated earnings in excess of billings on uncompleted contracts, net of approximately $0.5 million.

Net cash used in investing activities was approximately $50,000 in 2003 and $41,000 in 2002.

Net cash used in financing activities was $1,074,000 in 2003 due to the repayment of short term bank credit net. Net cash provided by financing activities was $962,000 in 2002 mainly due to the net proceeds of $835,000 from issuance of our shares in a private placement.

At December 31, 2003, we had a working capital deficiency of $2.7 million and cash and cash equivalents of $467,000 as compared to a working capital deficiency of $8 million and cash and cash equivalents of $570,000 at December 31, 2002.

We have been dependent in recent years on receiving financial support from our principal shareholders. We cannot assure that they will continue to provide us with funds when requested, and that such funds, if any, will be sufficient to finance our operations. The failure of our principal shareholders or other new investors to provide us with the necessary financing may result in a significant scale back or elimination of some aspects of our operations. Based on the anticipated continued financial support from our shareholders and existing and anticipated shipments in 2004, we anticipate that our capital resources will be adequate to satisfy our working capital and capital expenditure requirements until December 31, 2004. We may need to raise additional funds thereafter.

As of March 31, 2004 there were 18,074,032 warrants outstanding to purchase 18,074,032 of our ordinary shares. Of such warrants, 3,781,995 warrants have an exercise price of (par value) per share, 13,667,347 warrants have an exercise price of $2.00 per share and 624,690 warrants have exercise prices ranging from $2.17 to $6.25 per share. To the extent any warrants are exercised the proceeds will be added to our working capital.

C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES

Research and Development

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

In the years ended December 31, 2001, 2002 and 2003, our research and development costs (including capitalized costs in 2001) were $637,000, $122,000 and $0, respectively.

In 2003 we did not incur any research and development expenses. Since 2002 we have not capitalized any costs of development and in 2003 we made a strategic decision not to engage in internal research and development activities, but rather to develop products through customer orders. For example, in 2002 we engaged in the development of our GDS product and co-development of DAS, both as sub-contractors for Smiths Aerospace in connection with the PM-V Program. We intend to continue this approach for the foreseeable future.

As of December 31, 2003, we employed 27 engineers in research and development, which spend most of their time on research and development activities generated through customer orders and an immaterial part of their time on internal research and development activities.

The Office of the Chief Scientist of the Israeli Ministry of Industry and Trade encourages research and development by providing grants to Israeli companies. The terms of such grants prohibit manufacture of the developed products outside Israel and the transfer of technologies

developed using the grants to any person without the prior written consent of the Chief Scientist. We have not receive any grants from the Office of the Chief Scientist since 1996.

Pursuant to applicable Israeli law, we are currently required to pay royalties at the rate of 3-5% of sales of products developed with certain grants received from the Chief Scientist. The amount of royalties to be paid may not exceed the dollar value of the total grants received. As of December 31, 2003, our total obligation for royalties payments, net of royalties paid or accrued, is approximately $630,000.

We are committed to pay royalties to the Israel - United States Binational Industrial Research and Development Foundation at the rate of 2.5% up to 150% of the research and development expenses financed by the foundation. Our total obligation for royalties, net of royalties paid or accrued, totaled approximately $1.9 million as of December 31, 2003.

D. TREND INFORMATION

Based on our strategic plan, we have succeeded in reducing our losses over the last few years and achieved profitability for the year ending December 31, 2003. We cannot provide any assurances that we will be successful in meeting our targets in the future. As a result of the unpredictable business environment in which we operate, we are unable to provide any specific guidance as to sales and profitability trends.

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

- testing solutions;
- ground debriefing stations and avionics products for the F-16 aircraft of Lockheed Martin Aerospace;
- fighter and trainer up-grades based on our A-4 up-grade for the IAF; and
- manufacturing services.

If we are unsuccessful in our sales efforts, it is unlikely that we will be able to achieve profitability and we will require additional capital.

E. OFF-BALANCE SHEET ARRANGEMENTS

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

F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table summarizes our minimum contractual obligations and commercial commitments, as of December 31, 2003 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 years
Long-term debt obligations.....	$1,400,000	$180,000	$1,220,000	-	-
Capital (finance) lease obligations.....	-	-	-	-	-
Operating lease obligations.....	$717,000	$505,000	$191,000	$21,000	-
Purchase obligations.....	$84,000	$84,000	-	-	-
Other long-term liabilities reflected on the company's balance					

sheet under U.S. GAAP	-	-	-	-	-
Total.....	$2,201,000	$769,000	$1,411,000	$21,000	-

In addition, we have long-term liabilities for severance pay that is calculated pursuant to Israeli severance pay law generally based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. As of December 31, 2003 our severance pay liability was $2,048,000.

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

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

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

Our executive officers are responsible for our day-to-day management. The executive officers have individual responsibilities established by our chief executive officer and by the board of directors. Executive officers are appointed by and serve at the discretion of the board of directors, subject to any applicable employment agreements.

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

Name	Age	Position
Herzle Bodinger (1).....	61	Chairman of the board and president
Adar Azancot.....	39	Chief executive officer
Zvi Alon.....	50	Vice president, business development and marketing
Dov Sella.....	49	Vice president and Chief operating officer
Elan Sigal.....	37	Chief financial officer
Adrian Berg (2).....	56	Director
Asaf Agmon (5).....	56	Director
Roy Kui Chuen Chan (3).....	57	Director
Hava Snir (4).....	61	Outside director
Ben Zion Gruber (2).....	45	Director
Zvi Tropp (4).....	63	Outside director

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(1) Mr. Bodinger will serve as a director until our 2004 annual general meeting of shareholders.

(2) Messrs. Berg and Gruber will serve as directors until our 2005 annual general meeting of shareholders.

(3) Mr. Chan will serve as a director until our 2006 annual general meeting of shareholders.

(4) Ms. Snir and Mr. Tropp will serve as outside directors pursuant to the provisions of the Israeli Companies Law for three-year terms until our 2006 annual general meeting of shareholders. Thereafter, their terms of service may not be renewed.

(5) Mr. Agmon will serve as a director until our 2004 annual general meeting of shareholders.

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

Adar Azancot joined us in July 1997 as marketing manager in charge of marketing activities aimed at the Israel Defense Forces and was appointed vice president-business development in March 1999. Mr. Azancot was appointed chief executive officer in July 2001. Mr. Azancot served for 14 years as a fighter pilot in the Israeli Air Force while holding various command positions. Mr. Azancot holds an LL.B. degree in Law from Tel Aviv University.

Zvi Alon joined us in January 2000 and served as our vice president and chief operating officer until March 30, 2003 when he was appointed vice president of business development and Marketing. From 1980 to 1999 (except for a period from 1987 until 1989), Mr. Alon served in various managerial positions with the Israel Aircraft Industries, as director of business

development and marketing, director of electrical and avionics engineering, avionics programs manager and group leader and operational definition officer of the "Lavi" project office. Previously, Mr. Alon served in the Israeli Air Forces for ten years. Mr. Alon holds a B.Sc. degree in Mathematics and Computer Science and an M.Sc. degree in Computer Science, both from Tel Aviv University.

Dov Sella joined us in January 2003 and was appointed chief operating officer on March 30, 2003. Mr. Sella has over 20 years of senior management and product development experience. From 1982 until 1997 Mr. Sella worked for Elbit Systems Ltd., a leading Israeli defense contractor. Among his roles at Elbit were director of programs, director of avionics engineering and director of business development. Between 1997 and 2000 Mr. Sella served UltraGuide Ltd., a medical devices start-up, as executive vice president and

vice president of business development and vice president of research and development. During the three years prior to joining our company, Mr. Sella was the president of NeuroVision Inc., a medical technology start-up. Mr. Sella has a B.Sc. degree in Computer Engineering from the Technion Israel Institute of Technology (cum laude). He served as a fighter aircraft navigator in the Israeli Air Force.

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

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

Asaf Agmon served as non-employee independent director from May 1999 until December 2002. On December 2, 2003 he was nominated as a director by our Board and will serve as a director until our 2004 annual general meeting. Mr. Agmon has served as chief executive officer of Solgood Trading Ltd., an Israeli company, since 1998. Brigadier General (Res.) Agmon served in the Israeli Air Force from 1967 until 1998 as a fighter pilot while holding various command positions. During the last three years of his service, Mr. Agmon served as the Israeli Military and Defense Attache to Japan and South Korea. Mr. Agmon holds a B.A. degree in Economics and Business Administration from Tel Aviv University and an M.A. degree in International Affairs from Haifa University. Mr. Agmon is also a graduate of the RAF Staff College in the U.K.and of the National Defense Institute of Israel.

Ben Zion Gruber was elected as a designee of the shareholders (other than Howard Yeung) that participated in our last private placement. Mr. Gruber is founder and manager of several real estate and construction companies and an entrepreneur involved in several hi-tech companies. Mr. Gruber is a Colonel (Res) of the Israeli Defense Forces serving as Brigadier

Commander of a tank battalion. Mr. Gruber holds an M.A. degree in Behavioral Sciences from Tel Aviv University, a B.Sc. degree in Engineering of microcomputers from "Lev" Technology Institute and is currently studying for his PhD degree in Behavioral Sciences at the University of Middlesex, England. In addition Mr. Gruber is a graduate of a summer course in Business Administration at Harvard University, as well as several other courses and training in management, finance and entrepreneurship. Mr. Gruber is a member of the Board of Employment Service of the Government of Israel. He also serves on the boards of directors of the Company for Development of Efrat Ltd., and the Association of Friends of "Kefar Shaul" Hospital. Mr. Gruber serves on the Ethics Committees of the Eitanim and Kefar Shaul hospitals as well as a director of several other charitable organizations.

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

Hava Snir has served as an outside director since December 2000. Ms. Snir has been an attorney for over 25 years and has been self-employed since January 1999. From June 1989 until July 1998, Ms. Snir was a prosecutor with the Taxation and Economics Office of the Tel Aviv District Attorney, specializing in securities laws and white-collar crimes. Ms. Snir received her qualification as a lawyer and has been a member of the Israel Bar since 1971. She is a member of the Taxes Committee and the Sub-Committee for V.A.T. and Customs Duty of the Israel Bar Association and serves as chairman of the V.A.T. and Property Tax Appeal Committee of the Israeli Ministry of Finance and as a member of the Ethics Committee of the Israeli Ministry of Health. Ms. Snir holds a B.A. degree in Law from the Hebrew University of Jerusalem and spent a year at Harvard University where she took law courses.

Zvi Tropp has served as an outside director since December 2000. From November 2000 until April 2003, Mr. Tropp served as the chief executive officer of Enavis Networks Ltd, a wholly owned subsidiary of ECI Telecom Ltd. Since April 2003 Mr. Tropp has served as senior consultant with Zenovar Consultants Ltd. Zenovar an Israeli company providing consultancy services with respect to business organization, marketing and real estate. Mr. Tropp was vice president-finance and business development of Baltimore Spice Israel Ltd., an Israeli food additives manufacturer, from January 1994 until May 1998. Prior thereto, Mr. Tropp served in various positions in the private sector. Prior to joining the private sector, Mr. Tropp was a government employee for 20 years and held various positions with the Israeli Ministries of Defense and Agriculture, the last of which was as chief economic adviser to the Ministry of Defense. Mr. Tropp has lectured in Economics and Defense Economics at the Hebrew University, Tel Aviv University and Bar Ilan University. Mr. Tropp serves as a member of the board of directors of Ofek Trust Fund Ltd., an Israeli affiliate of Bank Leumi Le-Israel B.M., whose shares trade on the Tel Aviv Stock Exchange, and of several Israeli private companies. Mr. Tropp holds a B.Sc. degree in Agriculture and an M.Sc. degree in Agricultural Economics, both from the Hebrew University.

Guy Shelly served as our chief financial officer since June 1, 2002 until January 2004 and his employment with our company was terminated effective April 15, 2004.

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, 2003.

	Salaries, fees, commissions and	Pension, retirement

	bonuses	and similar benefits
All directors and executive officers as a group, consisting of eight persons	$685,986	$191,780

During the year ended December 31, 2003, we paid each of our outside directors a per meeting attendance fee of NIS 1,000 ($228) plus an annual fee of NIS 18,000 ($4,110).

As of December 31, 2003, our directors and executive officers as a group, consisting of eleven persons, held options to purchase an aggregate of 1,570,000 ordinary shares, at exercise prices ranging from $0.69 to $6.25 per share, vesting over three years. These options expire between 2009 and 2013. Of such options 144,000 options were issued under our 1999 employee stock option plan and 1,426,000 options were issued under our 2003 employee stock option plan. These options have ten year terms.

Additionally, as of December 31, 2003, our directors and officers as a group held warrants to purchase an aggregate of 177,041 ordinary shares, at exercise prices ranging from $2.00 to $2.75 per share. These warrants were purchased as part of the private placements of our shares (prior to the director nomination to office) in 2001 and 2002 of which 75,000 warrants expire on June 30, 2004 and 102,041 warrants expire on June 30, 2007.

C. BOARD PRACTICES

Election of Directors

Pursuant to our articles of association, the board of directors is divided into three classes. Generally, at each annual meeting of shareholders one class of directors is elected for a term of three years by a vote of the holders of a majority of the voting power represented and voting at such meeting. All the members of our board of directors (except the outside directors as detailed below) may be reelected upon completion of their term of office.

Alternate Directors

Our articles of association provide that any director may appoint, by written notice to us, another person to serve as an alternate director, subject to the approval of the board of directors. Pursuant to the Israeli Companies Law, any person, who is not already acting as director or alternate director in a company may act as an alternate director at such company, provided, however, that the same person may not act as an alternate for several directors. An alternate

director may be appointed for one meeting or for another specified period or until notice is given of the cancellation of the appointment. From April 2002 until the end of June 2002, Mr. Neil Myerson was appointed as an alternate director to replace Mr. Berg. To our knowledge, no director currently intends to appoint any other person as an alternate director, except if the director is unable to attend a meeting of the board of directors.

Outside and Independent Directors

The Israeli Companies Law requires Israeli companies with shares that have been offered to the public in or outside of Israel to appoint at least two

outside directors. No person may be appointed as an outside director if the person or the person's relative, partner, employer or any entity under the person's control has or had, on or within the two years preceding the date of the person's appointment to serve as outside director, any affiliation with the company or any entity controlling, controlled by or under common control with the company. The term affiliation includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an officer holder.

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 an outside director or may otherwise interfere with the person's ability to serve as an outside director. If, at the time outside directors are to be appointed, all current members of the board of directors are of the same gender, then at least one outside director must be of the other gender.

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

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

In addition, the Nasdaq Stock Market requires us to have at least two independent directors on our board of directors and to establish an audit committee. Ms. Snir and Mr. Tropp qualify both as independent directors under the Nasdaq Stock Market requirements and as outside directors under the Israeli Companies Law requirements. Mr. Agmon serves as our third independent director. Mr. Agmon qualifies as an independent director under the Nasdaq Stock Market requirements.

Approval of Related Party Transactions Under Israeli Law

The Companies Law codifies the fiduciary duties that "office holders,"

including directors and executive officers, owe to a company. 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. The duty of loyalty includes avoiding any conflict of interest between the office holder's position in the company and his personal affairs, avoiding any competition with the company, avoiding exploiting any business opportunity of the company in order to receive personal gain for the office holder or others, and disclosing to the company any information or documents relating to the company's affairs which the office holder has received due to his position as an office holder. Each person listed as a director or executive officer in the table under " -- Directors and Senior Management" above is an office holder. Under the Companies Law, all arrangements as to compensation of office holders who are not directors require approval of our board of directors, and the compensation of office holders who are directors must be approved by our audit committee, board of directors and shareholders.

The Companies Law requires that an office holder promptly disclose any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by 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 likely to 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 spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of the foregoing, 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. Some transactions, actions and arrangements involving an office holder (or a third party in which an office holder has an interest) must be approved by the board of directors or as otherwise provided for in a company's articles of association, as not being adverse to the company's interest. In some cases, such a transaction must be approved by the audit committee and by the board of directors itself (with further shareholder approval required in the case of extraordinary transactions). An office holder who has a personal interest in a matter, which is considered at a meeting of the board of directors or the audit committee, may not be present during the board of directors or audit committee discussions and may not vote on this matter, unless the majority of the members of the board or the audit committee have a personal interest, as the case may be.

The Companies Law also provides that some transactions between a public company and a controlling shareholder, or transactions in which a controlling shareholder of the company has a personal interest but which are between a public company and another entity, require the approval of the board of directors and of the shareholders. Moreover, an extraordinary

transaction with a controlling shareholder or the terms of compensation of a controlling shareholder must be approved by the audit committee, the board of directors and shareholders. The shareholder approval for an extraordinary transaction must include at least one-third of the shareholders who have no personal interest in the transaction and are present at the meeting. The transaction can be approved by shareholders without this one-third approval, if the total shareholdings of those shareholders who have no personal interest and voted against the transaction do not represent more than one percent of the

voting rights in the company.

However, under the Companies Regulations (Relief From Related Party Transactions), 5760-2000, promulgated under the Companies Law and amended in January 2002, certain transactions between a company and its controlling shareholder(s) do not require shareholder approval.

In addition, pursuant to the recent amendment to these regulations, directors' compensation and employment arrangements do not require the approval of the shareholders if both the audit committee and the board of directors agree that such arrangements are for the benefit of the company. If the director or the office holder is a controlling shareholder of the company, then the employment and compensation arrangements of such director or office holder do not require the approval of the shareholders provided that certain criteria are met.

The above exemptions will not apply if one or more shareholders, holding at least 1% of the issued and outstanding share capital of the company or of the company's voting rights, objects to the grant of such relief, provided that such objection is submitted to the company in writing not later than seven (7) 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 compensation arrangement of the directors will require shareholders' approval as detailed above.

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% shareholder of the company. This rule does not apply if there is already another 25% 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 become a 45% shareholder of the company, unless there is a 50% shareholder of the company. These rules do not apply if the purchase of the shares is made through a private placement. Regulations under the Companies Law provide that the Companies Law's tender offer rules do not apply to a company whose shares are publicly traded outside of Israel, if pursuant to the applicable foreign securities laws and stock exchange rules there is a restriction on the acquisition of any level of control of the company, or if the acquisition of any level of control of the company requires the purchaser to make a tender offer to the public shareholders.

Indemnification of Directors and Officers

The Companies Law provides that an Israeli company cannot exculpate an office holder from liability with respect to a breach of his duty of loyalty, but may exculpate in advance an office holder from his liability to the company, in whole or in part, with respect to a breach of his duty of care. Our articles of association provide that, subject to any restrictions imposed by

corporate law, we may enter into a contract for the insurance of the liability of any of our office holders with respect to:

- a breach of his duty of care to us or to another person;

- breach of his duty of loyalty to us, provided that the office holder acted in good faith and had reasonable cause to assume that his act would not prejudice our interests; or

- a financial liability imposed upon him in favor of another person in respect of an act performed by him in his capacity as an office holder.

In addition, we may indemnify an office holder against:

- a financial liability imposed on him in favor of another person by any judgment, including a settlement or an arbitrator's award approved by a court in respect of an act performed in his capacity as an office holder; and

- reasonable litigation expenses, including attorneys' fees, expended by such office holder or charged to him by a court, in proceedings we institute against him or instituted on our behalf or by another person, or in a criminal charge from which he was acquitted, all in respect of an act performed in his capacity as an office holder.

These provisions are specifically limited in their scope by the Companies Law, which provides that a company may not indemnify an office holder, nor enter into an insurance contract which would provide coverage for any monetary liability incurred as a result of certain improper actions.

Pursuant to the Companies Law, indemnification of, and procurement of insurance coverage for, our office holders must be approved by our audit committee and our board of directors and, in specified circumstances, by our shareholders.

We have indemnified our office holders to the fullest extent permitted by law. We currently maintain a directors and officers liability insurance policy with a per claim and aggregate coverage limit of $5.0 million.

Employment Agreements

On May 1, 1997, we entered into an employment agreement with Mr. Herzle Bodinger who assumed the position of the general director of our International Division. Mr. Bodinger was appointed our chief executive officer and president in June 1998. Nonetheless, his terms of employment have not changed. The agreement provides for a base salary and a package of benefits including options and warrants and contains certain non-competition and confidentiality provisions. The agreement does not provide for any benefits upon termination of employment, except for benefits to which Mr. Bodinger is entitled under Israeli law. Such benefits include

severance payments equal to one month salary per each year of employment with us. Under the agreement, the term of Mr. Bodinger's employment will continue until such time as it is terminated by us, subject to providing Mr. Bodinger with a six-month prior notice. Mr. Bodinger may terminate the agreement on a one-month prior notice. As of October 24, 2001, Mr. Bodinger relinquished the chief executive officer position to Adar Azancot retaining the positions of president and chairman of our Board of Directors. We are currently negotiating a new employment agreement with Mr. Bodinger. As part of these negotiations, Mr. Bodinger has agreed, effective as of September 2003, to reduce his monthly salary. During 2003, Mr. Bodinger agreed to a further reduction in his salary as

of February 1, 2004.

On July 9, 2001, we entered into an employment agreement with Mr. Adar Azancot, our chief executive officer. The agreement provides for the same base salary and a package of customary benefits Mr. Azancot had as vice president of marketing and business development and contains certain non-competition and confidentiality provisions. In September 2002 our board of directors resolved to increase Mr. Azancot's base salary. In addition to severance payments equal to one month salary per each year of employment with us as provided under Israeli law, Mr. Azancot was also entitled to a one time payment equal to six times his last gross salary in the event his employment is terminated by us. In 2003, Mr. Azancot waived this right.

Audit Committee

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

Our Audit Committee consist of three board members who satisfy the "independence" requirements of the SEC, Nasdaq and Israeli Law for audit committee members. Our audit committee is currently composed of Ms. Hava Snir and Messrs. Zvi Tropp and Asaf Agmon, each of whom satisfies these requirements. The audit committee meets at least once each quarter.

Under Israeli law, an audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder, unless at the time of approval two outside directors are serving as members of the audit committee and at least one of the outside directors was present at the meeting in which an approval was granted.

The Audit Committee reviewed our audited financial statements for the year ended December 31, 2003 and members of the committee met with both management and our external auditors to discuss those financial statements. Management and the external auditors have represented to the Audit Committee that the financial statements were prepared in accordance

with the generally accepted accounting principles. Members of the Audit Committee have received from and discussed with the external auditors their written disclosure and letter regarding their independence from our company as required by Independence Standards Board Standard No. 1. Members of the Audit Committee also discussed with the external auditors any matters required to be discussed by Statement on Auditing Standards No. 61. Based upon these reviews and discussions, the Audit Committee has recommended to the Board of Directors that the audited financial statements be included in our Annual Report on Form 20-F for the year ended December 31, 2003.

Other Committees

Our Board of Directors has also established a Compensation Committee composed of Mr. Zvi Trop and Mr. Adrian Berg. The Compensation Committee is authorized to determine all compensations issues, especially to administer the Company's option plans and to make recommendations to the Board of Directors in connection with option grants to employees and directors of the Company and the terms thereof. The Committee will also make recommendation to the board in connection with the terms of employment of the CEO and the president of the Company.

Internal Audit

The Israeli Companies Law also requires the board of directors of a public company to appoint an internal auditor nominated by the audit committee. A person who does not satisfy the 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. Our internal auditor complies with the requirements of the Companies Law.

D. EMPLOYEES

On December 31, 2003, we employed 99 persons, of whom 27 were employed in research, development and engineering, 54 persons in manufacturing and logistics, 4 persons in sales and marketing, and 11 persons in administration and management and finance. All of our employees are located in Israel. In addition, CACS (our 80% owned subsidiary) employed 18 persons in China.

On December 31, 2002, we employed 104 persons, of whom 27 were employed in research, development and engineering, 69 persons in manufacturing and logistics, 4 persons in sales and marketing, and 10 persons in administration and management and finance. All of our employees are located in Israel. In addition, CACS (our 80% owned subsidiary) employed 16 persons in China.

On December 31, 2001, we employed 94 persons, of whom 20 were employed in research, development and engineering, 65 persons in manufacturing and logistics, 3 persons in sales and marketing, and 6 persons in administration and management and finance. All of our employees are located in Israel. In addition, CACS (our 80% owned subsidiary) employed 15 persons in China.

Our technical employees have signed nondisclosure agreements covering all proprietary information that they might possess or to which they might have access. Employees are not organized in any union, although they are employed according to provisions established by the Israeli Ministry of Labor. Certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Industrialists Association) are applicable to our Israeli employees by order of the Israeli Ministry of Labor. These provisions concern mainly the length of the workday, minimum daily wages for professional workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. We generally provide our employees with benefits and working conditions beyond the required minimums. Under the collective bargaining

agreements, the wages of most of our employees are linked to the Israeli consumer price index, although the extent of the linkage is limited.

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

E. SHARE OWNERSHIP

Beneficial Ownership of Executive Officers and Directors

The following table sets forth certain information as of March 31, 2004 regarding the beneficial ownership by each of our directors and executive officers:

Name	Number of Ordinary Shares Beneficially Owned (1)	Percentage of Ownership (2)
Herzle Bodinger (3).....	125,000	*
Adrian Berg (5).....	109,600	*
Asaf Agmon (3).....	33,333	*
Roy Kui Chuen Chan (6).....	76,267	*
Ben Zion Gruber (3)(7).....	197,874	1.1%
Hava Snir (3).....	--	--
Zvi Tropp (3)	--	--

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* Less than 1%

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

subject to community property laws where applicable, the persons named in the table above have sole voting and investment power with respect to all shares shown as beneficially owned by them.

(2) The percentages shown are based on 18,542,383 ordinary shares issued and outstanding as of March 31, 2004.

(3) The business addresses of Messrs. Bodinger, Alon, Sela, Shelly, Sigal, Azancot, Agmon, Gruber, Tropp and Ms. Snir is c/o RADA Electronic

Industries Ltd., 7 Giborei Israel Street, Netanya, Israel.

(4) All such ordinary shares are subject to currently exercisable options granted under our stock option plan, 48,000 options at an exercise price of $3.75 per share, 48,000 options at an exercise price of $5.00 per share, 48,000 options at an exercise price of $6.25 per share and 33,333 options at an exercise price of $0.69 per share. 144,000 options expire in June 2010 and 33,333 options in September 2013.

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

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

(7) Includes 177,041 ordinary shares issuable upon currently exercisable warrants at an exercise price of $2.00 per share that were issue in connection with the private placement of our shares in June 2002.

In 2003 we granted warrants to purchase 854,000 ordinary shares to Messrs. Bodinger, Berg, Chan, Agmon and Gruber. Such grants were approved by our shareholders at an Extraordinary Shareholders Meeting that took place on March 9, 2004.

Stock Option Plans

1994 Stock Option Plan

Our 1994 Stock Option Plan, or the 1994 Plan, provides for the issuance of stock options to purchase an aggregate of 40,400 of our ordinary shares. Options under the 1994 Plan may be issued to outside directors, consultants, officers and other key employees of our company and its subsidiaries who, in the judgment of the board of directors or, if appointed in the future, a committee which will administer the 1994 Plan, are in a position to contribute significantly to our success. The board of directors or the committee will determine the number of shares covered by each option, and the formulation, within the limitations of the 1994 Plan, of the form of option.

Options granted under the 1994 Plan may be for a maximum term of ten years from the date of grant. The 1994 Plan itself will expire on November 23, 2004 (unless terminated earlier by an action of the board of directors) and no options can be granted after such date. The exercise price of an option granted to an employee may not be less than 60% of the fair market value of our ordinary shares on the date of grant of the option. The exercise price of an option to a non-employee director or consultant may not be less than 80% of the fair market value of our

ordinary shares on the date of grant of the option. If any option expires without having been fully exercised, the shares with respect to which such option has not been exercised will be available for future grants.

Options may not be transferable by the optionee otherwise than by will or the laws of descent and distribution and during the optionee's lifetime are exercisable only by the optionee. Options terminate before their expiration

dates one year after the optionee's death while in our employ, three months after the optionee's retirement for reasons of age or disability or involuntary termination of employment other than for cause, and immediately upon voluntary termination of employment or involuntary termination of employment for cause.

Our board of directors may, at its discretion, modify, revise or terminate the 1994 Plan at any time, except that the aggregate number of shares issuable pursuant to options may not be increased (except in the event of certain changes in our capital structure), the eligibility provisions and minimum option price may not be changed, or the permissible maximum term of options may not be increased without the consent of our shareholders.

The 1994 Plan also contains provisions protecting optionees against dilution of the value of their options in the case of stock splits, stock dividends or other changes in our capital structure, in the event of any proposed reorganization or merger involving our company or in the event of any spin-off or distribution of assets to our shareholders.

As of March 31, 2004, options to purchase 40,400 ordinary shares had been granted to 9 employees at an average exercise price of $4.347 per share. All of such options to are currently exercisable. To date, no options have been exercised.

1996 Stock Option Plan

Our 1996 Stock Option Plan, or the 1996 Plan, authorizes the issuance of options to key employees and consultants, including officers and directors of our company and its subsidiaries, to purchase an aggregate of 5,600 ordinary shares, who, in the judgment of the board of directors or, if appointed in the future, a committee which will administer the 1996 Plan, are in position to contribute significantly to our success. The terms of the 1996 Plan are substantially the same as those of the 1994 Plan. As of March 31, 2004, options to purchase 5,600 ordinary shares had been granted to 3 employees and directors at an average exercise price of $3.68 per share. All of such options are currently exercisable. No options have been exercised to date.

1999 Stock Option Plan

Our 1999 Stock Option Plan, or the 1999 Plan, provides for the issuance of stock options to purchase an aggregate of 1,040,000 of our ordinary shares. Options under the 1999 Plan may be issued to key employees and consultants, including officers and directors of our company and its subsidiaries who, in the judgment of the board of directors or, if appointed in the future, a committee which will administer the 1999 Plan, are in a position to contribute significantly to our success. The terms of the 1999 Plan are substantially the same as those of the 1994 Plan. As of March 31, 2004, options to purchase 289,200 ordinary shares had been granted to 15 employees at an average exercise price of $4.42 per share. Of such options, options to purchase 289,200 ordinary shares are currently exercisable.

2003 Stock Option Plan

Our 2003 Stock Option Plan, or the 2003 Plan, provides for the issuance of stock options to purchase an aggregate of 2,000,000 of our ordinary shares. Options under the 2003 Plan may be issued to employees including officers and

directors of our company and its subsidiaries who, in the judgment of the board of directors based on the recommendation of our compensation committee, are in a position to contribute significantly to our success. The provisions of our 2003 Plan are designated to allow for the tax benefits promulgated under the Israeli Income Tax Ordinance [New Version]. Our Board of Directors has resolved that all options that will be granted to Israeli residents under the 2003 Plan will be taxable under the "capital gains path." Pursuant to this path the profit realized by the employee is taxed as a capital gain (25%) if the options or shares are held by a trustee for at least 24 months from the end of the tax year in which such options were granted. If the shares are sold before the lapse of said 24 months period, the profit is re-characterized as ordinary income. The company is not allowed a corresponding salary expense, even in the event the profit is taxed as ordinary income. Otherwise, the terms of the 2003 Plan are substantially the same as those of the 1994 Plan. As of March 31, 2004 options to purchase 998,000 ordinary shares had been granted. Of such options, options to purchase 357,666 ordinary shares are currently exercisable and 31,667 options have been exercised.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS

The following table sets forth certain information as of March 31, 2004, regarding the beneficial ownership by all shareholders known to us to own beneficially 5% or more of our ordinary shares:

Name	Number of Ordinary Shares Beneficially Owned(1)	Percentage of Ownership(2)
Howard P.L. Yeung (3)(4)(5)(6).....	20,672,973	67.1%
Kenneth Yeung (3)(7).....	1,350,086	7.3%
Most Worth Investments Limited (8)....	1,100,000	5.9%

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

(2) The percentages shown are based on 18,542,383 ordinary shares outstanding as of March 31, 2004.

(3) Of the 20,672,973 ordinary shares, 1,350,086 shares are held directly by Horsham Enterprises Ltd., a corporation incorporated in the British Virgin Islands. Messrs. Howard P.L. Yeung and his brother Kenneth Yeung are the beneficial owners, in equal shares, of Horsham Enterprises Ltd.

Accordingly, Messrs. Yeung may be deemed to be the beneficial owners of the ordinary shares held by Horsham Enterprises Ltd.

(4) Includes 8,501,218 ordinary shares issuable upon the exercise of currently exercisable warrants issued to Mr. Howard P.L. Yeung.

(5) Includes 3,781,991 ordinary shares issuable to Mr. Howard P.L. Yeung in the event he acquires warrants from Bank Leumi le-Israel B.M. and Bank Hapoalim BM. by exercising a call option granted to him by such banks pursuant to an option agreement dated September 24, 2003.

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

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

(8) The address of Most Worth Investments Ltd., a company incorporated in Hong Kong, is c/o 9/F King Fook Building, 30-32 Des Voeux Road, Central, Hong Kong. Most Worth Investments is a wholly owned subsidiary of King Fook Holdings Limited, whose shares are traded on the Hong Kong Stock Exchange. Accordingly, King Fook Holdings may be deemed to be the beneficial owner of the ordinary shares held by Most Worth Investments.

As of April 6, 2004, there were 325 holders of record of our ordinary shares. Based on a review of the information provided to us by our transfer agent, 290 record holders holding approximately 67.5% of our ordinary shares had registered addresses in the United States. We believe that there were approximately 1,214 beneficial holders of our ordinary shares on April 7, 2004.

B. RELATED PARTY TRANSACTIONS

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

On June 9, 2002, our shareholders approved the conversion of $1,350,000 of the principal amount of loans granted by Mr. Howard P.L. Yeung, one of our controlling shareholders into 2,755,102 of our ordinary shares at a price of $0.49 per share, which is equal to 70% of the average closing price of our ordinary shares for the ten (10) trading days prior to June 9, 2002. In addition, we agreed to issue to Mr. Yeung warrants to purchase 8,265,306 ordinary shares. Such warrants will be outstanding for five years and will be exercisable during the first 36 months at an exercise price of $2.00 per share, and during the subsequent 24 month period, at an exercise price which shall be equal to the higher of: (i) $2.00 per share or (ii) 50% of the average closing price of our ordinary shares during the ten (10) trading days prior to the exercise date.

We also agreed to provide Mr. Yeung with the right to cause us to file a registration statement with the U.S. Securities Exchange Commission commencing one year after the

issuance date, to register the resale of the ordinary shares issued and the

ordinary shares issuable upon exercise of the warrants.

On June 22, 2003 we signed a memorandum of agreement with Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M., or the Banks, which agreement was approved by our shareholders at an extraordinary general meeting of shareholders that was held on July 22, 2003. Pursuant to the agreement, or the Agreement, that was finalized on September 24, 2003, we restructured $3,451,000 of our outstanding debt to the Banks. We repaid $1,100,000 on account of our debt the Banks, and the Banks forgave $1,100,000 of debt and received warrants to purchase 3,781,995 of our ordinary shares, at an exercise price that is equal to the nominal (par) value of our shares, in lieu of $1,251,000 of our debt. These warrants may not be exercised for a period of 21 months unless transferred pursuant to the call or put options described below. These warrants expire on March 24, 2006. The Banks have also agreed to grant us an additional short-term line of credit of $500,000 to finance our cash flow requirements during 2003. As part of the Agreement, our controlling shareholder, Mr. Howard P. L. Yeung, has agreed to grant the Banks a put option allowing the Banks to require him to purchase the above warrants for the consideration of $1,251,000, exercisable within a period of 45 days commencing on March 24, 2005 and the Banks granted Mr. Yeung a call option allowing him to require the Banks, during a period of 18 months, commencing as of September 24, 2003, and in the event that the Banks will not exercise their put option, during additional 90 days period commencing as of May 9, 2005, to sell him such warrants at a price that is not lower than $1,251,000 and not higher then $1,770,165, pending upon the average close price of the shares during the last 90 business days prior to such exercise. We have also agreed to grant the Banks warrants to purchase an additional 1,100,000 ordinary shares at an exercise price of $2.00 per share, exercisable for 5 years, commencing as of September 24, 2003.

C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

Legal Proceedings

In December 1998, Haim Nissenson, our former president and chief executive officer, filed a complaint against us and Herzle Bodinger, the incumbent president, in the Regional Court for Labor Disputes of Tel Aviv (Case No. 3/4074/98 H. Nissenson v. RADA ELECTRONIC INDUSTRIES Ltd. and others), seeking approximately NIS 2.0 million (approximately $500,000) for salary, vacation and severance payments and other benefits that he is allegedly entitled to pursuant to his retirement agreement with us. In addition, Mr. Nissenson is seeking a permanent injunction and a declarative relief, stating that a personal loan that was provided to him by us had been forgiven. Mr. Nissenson is also asserting that Mr. Bodinger caused the breach of the retirement agreement. We defended the claim vigorously asserting, among others, that (i) the retirement agreement is not valid since it was not approved pursuant to the requirements of the applicable law; (ii) Mr. Nissenson is responsible for our present financial

condition and for the concealment of these facts from our board of directors and our investors; (iii) during the board of directors meeting in which such agreement was discussed and approved, Mr. Nissenson gave misrepresentations regarding our financial and economic condition and the nature and origins of his debt to us; and (iv) by breaching his fiduciary duties Mr. Nissenson caused us damages in amounts that exceed the amount of the complaint, which damages should be offset from any amounts awarded in favor of Mr. Nissenson, if any. In addition, we asserted that in accordance to a certificate dated March 23, 1992, Mr. Nissenson has assigned all his rights to receive employment related benefits other than salaries but including severance and vacation payments up to the above certificate date. The hearing of this claim was combined with the hearing of our claim for repayment of the loan granted to Mr. Nissenson, as detailed below and a preliminary hearing took place in 2003. Although the claim is in its preliminary stages, management believes it will not have a material adverse effect on our financial condition or results of operations.

In March 1999, Mr. Nissenson filed a complaint in the District Court of Tel Aviv against Mr. Bodinger, our president, (Civil Case 1345/99 H. Nissenson v. H. Bodinger), alleging Mr. Bodinger published defamatory comments about Mr. Nissenson. The complaint seeks damages in the amount of NIS 1.2 million (approximately $275,000). Mr. Bodinger denied the allegations, alleging, among others, that the statements made by him in these publications were truthful and bona fide. In October 2000, Mr. G. Nissenson, the son of our former chief executive officer, filed a complaint in the District Court of Tel-Aviv against our chief executive officer, Mr. H. Bodinger (Civil Case 2733/99 G. Nissenson v. H. Bodinger), alleging that Mr. Bodinger has made defamatory comments regarding the plaintiff during a board meeting. The complaint seeks damages in the amount of NIS 1.1 million (approximately $250,000).

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

In August 2000, we filed a claim against Mr. Nissenson in the Regional Court for Labor Disputes in Tel Aviv (Case No. 7049/00 RADA Electronic Industries Ltd. v. Nissenson.) in the amount of NIS 2.0 million (approximately $460,000) for the repayment of the loan granted by us to Mr. Nissenson that allegedly was forgiven by us in Mr. Nissenson's retirement agreement, as mentioned above. The hearings of both Mr. Nissenson's and our claims in the Regional Court for Labor Disputes were joined and preliminary hearing of the cases took place in 2003. In the hearing the Court ordered the parties to file an agreed list of factual controversies and

agreements in order to enhance the efficiency of the process and eliminate unnecessary evidential matters.

In November 2000, Mr. Nissenson filed a suit against us, Mr. Bodinger and Mr. Ronen Stein, our chief financial officer at the time, in the District Court of Tel Aviv (Civil Case 2882/00 Nissenson v. RADA Electronic Industries Ltd. and others), seeking damages in the amount of NIS 1.0 million (approximately $230,000) and alleging that the description of the claim filed against him and another former director in connection with the acquisition of our subsidiary Jetborne International, Ltd. included in our Annual Report on Form 20-F for the year ended December 31, 1999 contains defamatory allegations with respect to Mr. Nissenson. We believe that we and our officers have valid defenses against these claims. According to Israeli law, the usual award in defamatory claims is low and does not exceed NIS 500,000 (approximately $115,000).

In May 2001, Mr. Nissenson filed a suit against us in the District Court of Tel Aviv (Civil Case 1715/01 H. Nissenson v. RADA Electronic Industries Ltd.) for damages allegedly suffered by him as a result the cancellation of an attachment imposed by us on his pension funds in connection with the previously mentioned Jetborne International litigation. The claim is for NIS 1.0 million (approximately $230,000). We are defending the suit vigorously and denied all of Mr. Nissenson's allegations. In June 2001, we filed a counter claim against Mr. Nissenson, his wife and another former director for damages caused to us as a result of transfers of funds to third parties who were made due to breaches by Mr. Nissenson and the other former director of their fiduciary duties toward us. In addition, we are seeking a declaratory judgment stating that Mrs. Nissenson is liable to us for the repayment of the loan provided to Mr. Nissenson, jointly with Mr. Nissenson. We are also seeking a declaration that the transfer of the title to Mr. Nissenson's house and another apartment to his wife without consideration in the beginning of 1997 are void and were made to avoid the repayment of outstanding loans to us.

In January 2001, we filed a suit against our former controller, Mr. Mordechai Perera in the Regional Court for Labor Disputes in Tel Aviv (Case No. 1672/01 RADA Electronic Industries Ltd. v. Perera) in the amount of approximately $300,000 for the repayment of a loan provided to him by us. While Mr. Perera does not deny that he received such amount, he claims that it was promised to him on account of his compensation and was registered as a loan in the books of the company for tax purposes. He further claims that he was orally promised by Mr. Nissenson that such loan would later be forgiven. In March 2001, Mr. Perera filed a counter claim in the amount of approximately $575,000 for various payments to which he is allegedly entitled in connection with his employment and termination thereof by us, including bonus, severance payments, vacation redemption and overtime payments.

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

In May 2001, Mr. David Kenig, a former member of our board of directors, filed a claim against us in the District Court of Tel Aviv (Civil Case 1791/01 Kenig v. RADA Electronic Industries Ltd.) seeking a declaration that he is entitled to receive options to purchase 600,000 of our ordinary shares under the same terms and conditions as those granted by us to other directors in 1999, and an injunction enforcing us to issue such options to him. Based on legal advice, we believe that the claim has no merits. In July 2001 we filed a counter-claim in the amount of NIS 500,000. In the counter-claim we maintain that Mr. Kenig is personally responsible for executing Mr. Nissenson's retirement agreement and that in such capacity he breached his fiduciary and care duties towards us and should the Labor Court decide that the retirement agreement is valid and enforceable against us, then Mr. Kenig has to indemnify us for all the damages caused to us as a result of such Labor Court decision. The District Court has issued a stay of the hearings pending resolution of the Labor Court proceedings detailed above.

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

Dividend Distribution

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

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

B. SIGNIFICANT CHANGES

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

ITEM 9. THE OFFER AND LISTING

A. OFFER AND LISTING DETAILS

Annual Stock Information

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

Year	High *	Low *
1999	$4.7655	$2.3437
2000	10.4687	1.7967
2001	2.577	1.48
2002	1.8	0.54
2003	2.37	0.41

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 National Market:

2002	High	Low
First Quarter	$1.8	$1.55
Second Quarter	1.63	0.6
Third Quarter	0.72	0.6
Fourth Quarter	0.64	0.54
2003		
First Quarter	$0.68	$0.57
Second Quarter	1.04	0.41
Third Quarter	0.76	0.59
Fourth Quarter	2.37	0.53

Monthly Stock Information

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

2003	High	Low
October	$1.52	$0.53
November	2.12	1.16
December	2.37	1.41
2004		
January	$2.08	$1.68
February	1.85	1.55
March	1.93	1.31

B. PLAN OF DISTRIBUTION

Not applicable.

C. MARKETS

Our ordinary shares have traded on the Nasdaq National Market under the symbol RADIF since our initial public offering in 1985 until June 10, 2002 when the listing of our ordinary shares was transferred to the Nasdaq SmallCap Market.

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

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

On February 1, 2000, the Israeli Companies Law, 1999-5759, or the Companies Law, came into effect and superseded most of the provisions of the Israeli Companies Ordinance (New Version), 5743-1983, except for certain provisions which relate to liens, bankruptcy, dissolution and liquidation of companies. Under the Companies Law, various provisions, some of which are detailed below, overrule the current provisions of our articles of association.

The Powers of the Directors

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

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

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

Rights Attached to Shares

Our authorized share capital consists of 45,000,000 ordinary shares of a nominal value of NIS 0.005 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." If after one year a dividend has been declared and it is still unclaimed, the board of directors is entitled to invest or utilize the unclaimed amount of dividend in any manner to our benefit until it is claimed. We are not obligated to pay interest or linkage differentials on an unclaimed dividend.

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

An ordinary resolution, such as a resolution for the declaration of dividends, requires approval by the holders of a majority of the voting rights represented at the meeting, in person, by proxy or by written ballot and voting 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 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. See "Item 6A. Directors, Senior Management and Employees - Election of Directors."

Rights to share in the company's profits. Our shareholders have the right to share in our profits distributed as a dividend and any other permitted distribution. See "- Rights Attached to Shares - Dividend Rights."

Rights to share in surplus in the event of liquidation. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to the nominal value of their holdings. This right may be affected by the

grant of preferential dividend or distribution rights to the holders of a class of shares with preferential rights that may be authorized in the future.

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

Limitations on any existing or prospective major shareholder. See Item 6A. "Directors and Senior Management - Approval of Related Party Transactions Under Israeli Law."

Changing Rights Attached to Shares

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

Annual and Extraordinary Meetings

The board of directors must convene an annual meeting of shareholders at least once every calendar year, within fifteen months of the last annual meeting. Notice of at least twenty-one days prior to the date of the meeting is required. An extraordinary meeting may be convened by the board of directors, as it decides or upon a demand of any two directors or 25% of the directors, whichever is lower, or of one or more shareholders holding in the aggregate at least 5% of our issued capital and at least 1% of the voting rights in our company. An extraordinary meeting must be held not more than thirty-five days from the publication date of the announcement of the meeting.

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

Limitations on the Rights to Own Securities in Our Company

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

Provisions Restricting Change in Control of Our Company

The Companies Law requires that mergers between Israeli companies be approved by the board of directors and general meeting of shareholders of both parties to the transaction. The approval of the board of directors of both companies is subject to such board's confirmation that there is no reasonable doubt that after the merger the surviving company will be able to fulfill its obligations towards its creditors. Each company must notify its creditors about the contemplated

merger. Under the Companies Law, our articles of association are deemed to include a requirement that such merger be approved by an extraordinary resolution of the shareholders, as explained above. The approval of the merger by the general meetings of shareholders of the companies is also subject to additional approval requirements as specified in the Companies Law and regulations promulgated thereunder. See also "Item 6A. Directors, Senior Management and Employees - Directors and Senior Management - Approval of Related Party
Transactions Under Israeli Law."

Disclosure of Shareholders Ownership

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

Changes in Our Capital

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

C. MATERIAL CONTRACTS

None.

D. EXCHANGE CONTROLS

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

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

E. TAXATION

The following is a summary of the current tax structure applicable to companies in Israel, with special reference to its effect on us and our shareholders. The following also contains a discussion of Israeli government programs benefiting us. To the extent that the discussion is based on a new tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the tax authorities will accept the views expressed in the discussion in question. The discussion is not intended, and should not be taken, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

General Corporate Tax Rate

In general, Israeli companies are currently subject to Company Tax at the rate of 36% of taxable income. However, the effective tax rate payable by a company, which derives income from an "approved enterprise" (as further discussed below), may be considerably less. Subject to relevant tax treaties, dividends or interest received by an Israeli corporation from foreign subsidiaries are generally subject to tax regardless of its status as an approved enterprise.

Law for the Encouragement of Capital Investments, 1959

Certain of our facilities have been granted "approved enterprise" status under the Law for the Encouragement of Capital Investments, 1959, as amended, or the Investment Law. The Investment Law provides that a capital investment in eligible facilities may, upon application to the Israel Investment Center, 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 its physical characteristics, e.g., the equipment to be purchased and utilized pursuant to the program. The tax benefits derived from any such certificate of approval relate only to taxable income attributable to the specific approved enterprise.

Taxable income of a company derived from an approved enterprise is subject to Company Tax at the rate of 0% to 25% (rather than 36% as stated above) for the benefit period: a period of seven years commencing with the year in which the approved enterprise first generated taxable income (limited to twelve years from commencement of the operations of the approved enterprise or of production or fourteen years from the date of approval, whichever is earlier) and, under certain circumstances, where foreign shareholdings in our company exceed 25%, extending to a maximum of ten years from the commencement date. In the event a company is operating under more than one approval or that its capital investments are only partly approved, its effective Company Tax rate is the result of a weighted combination of the various applicable rates.

In addition, a company owning an approved enterprise approved after April 1, 1986 may elect (as we have) to forego certain Government grants extended to approved enterprises in return for an "alternative package" of tax benefits. Under the alternative package, a company's undistributed income derived from an approved enterprise will be exempt from Company Tax for a period of between two and ten years, depending on the geographic location of the approved enterprise within Israel, and such company will be eligible for the standard tax benefits under the Investment Law for the remainder of the benefit period.

A company that has elected the alternative package and that subsequently pays a dividend out of income derived from the approved enterprise(s) during the tax exemption period will be subject to Company Tax in the year the dividend is distributed in respect of the amount distributed at the rate that would have been applicable had the company not elected the alternative package (generally 25%). The dividend recipient is taxed at the reduced rate applicable to dividends from approved enterprises (15% as compared to 25%), if the dividend is distributed during the tax exemption period or within a specified period thereafter. This tax must

be withheld by the company at source, regardless of whether the dividend is converted into foreign currency.

Subject to certain provisions concerning income subject to the alternative package, all dividends are considered to be attributable to the entire enterprise and the effective tax rate is the result of a weighted combination of the various applicable tax rates.

The Investment Law also provides that an approved enterprise is entitled to accelerated depreciation on its property and equipment that are included in an approved investment program. We have not utilized this benefit.

Three expansion programs of our production facilities have been granted "approved enterprise" status under the Law. The period of benefits for the first program terminated in 1991 and the benefits under the second program terminated in 1995. The period of benefits for the third program will terminate in 2004.

The above tax benefits are conditioned upon fulfillment of the requirements stipulated by the Investment Law and the regulations promulgated thereunder, as well as the criteria set forth in the certificates of approval. In the event of our failure to comply with these conditions, the tax benefits could be canceled, in whole or in part, and we would be required to refund the amount of the canceled benefits, plus interest and certain inflation adjustments.

Law for the Encouragement of Industry (Taxes), 1969

We believe that we currently qualify as an "industrial company" within the meaning of the Law of the Encouragement of Industry (Taxes), 1969 (the "Industry Encouragement Law"). According to the Industry Encouragement Law, an "industrial company" is 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 defense loans, capital gains, interest and dividends) is derived from an "industrial enterprise" that it owns. An "industrial enterprise" is defined by that law as an enterprise whose major activity in a given tax year is industrial production activity.

The following preferred Company Tax benefits are available to industrial companies such as ours:

- Deduction of purchases of know-how and patents over eight years for tax purposes.
- Deduction of expenses incurred in connection with a public share issuance over a three-year period.
- Accelerated depreciation rates on equipment and buildings.
- A right to file, under certain conditions, consolidated tax returns with related Israeli industrial companies.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. We cannot assure you that we will

continue to qualify as an "industrial company" or that the benefits described above will be available in the future.

Taxation under Inflationary Conditions

The Income Tax Law (Inflationary Adjustments), 1985, or the Adjustment for Inflation Law represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. Generally, the Adjustment for Inflation Law was designed to neutralize for Israeli tax purposes the erosion of capital investments in businesses and to prevent unintended tax benefits resulting from the deduction of inflationary financing expenses. The Adjustment for Inflation Law applies a supplementary set of inflationary adjustments to a normal taxable profit computed according to regular historical cost principles.

The Adjustment for Inflation Law introduced a special adjustment for the preservation of equity for the tax purpose based on changes in the Israeli consumer price index, whereby corporate assets are classified broadly into fixed (inflation resistant) assets and non-fixed assets. Where the shareholders' equity, as defined in the Adjustment for Inflation Law, exceeds the depreciated costs of fixed assets, a corporate tax deduction which takes into account the effect of inflationary change on such excess is allowed (up to a ceiling of 70% of taxable income in any single tax year, with the unused portion permitted to be carried forward on an inflation-linked basis with no ceiling). If the depreciated costs of fixed assets exceeds shareholders' equity, then such excess multiplied by the annual rate of inflation is added to taxable income.

In addition, subject to certain limitations, depreciation on fixed assets and loss carry forwards are adjusted for inflation based on changes in the Israeli consumer price index. The net effect of the Adjustment for Inflation Law on us might be that our taxable income, as determined for Israeli Company Tax purposes, will be different from our U.S. dollar income, as reflected in our financial statements, due to the difference between the annual changes in the consumer price index and in the NIS exchange rate with respect to the U.S. dollar, causing changes in the actual tax rate.

Law for the Encouragement of Industrial Research and Development, 1984

Under the Law for the Encouragement of Industrial Research and Development, 1984, or the Research Law, and the Instructions of the director general of the Ministry of Industry and Trade, research and development programs and the plans for the intermediate stage between research and development and manufacturing and sales, approved by a governmental committee of the Office of the Chief Scientist are eligible for grants of up to 50% of the project's expenditure if they meet certain criteria. These grants are issued in return for the payment of royalties from the sale of the product developed in accordance with the program as follows: 3% of revenues during the first three years, 4% of revenues during the following three years, and 5% of revenues in the seventh year and thereafter, with the total royalties not to exceed 100% of the dollar value of the Office of the Chief Scientist grant (or in some cases up to 300%). Following the full payment of such royalties, there is no further liability for payment.

The Israeli government requires that the manufacture of products developed with government grants be performed in Israel, unless a special approval has been granted. Separate Israeli government consent is required to

transfer to third parties technologies developed through

projects in which the government participates. Such restrictions do not apply to exports from Israel of products developed with such technologies.

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

Taxation of Non-Residents

The State of Israel imposes income tax on non-residents of Israel on income accrued or derived from sources in Israel or received in Israel by non-residents. The sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. We are required to withhold income tax at the rate of 25%, or 15% for dividends of income generated by an approved enterprise, on all distributions of dividends other than bonus shares (stock dividends), unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. Under the Convention between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income, or the Israeli-U.S. Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a U.S. resident (as defined in the treaty) is 25%.

Israel law imposes a capital gains tax on the sale of securities and other capital assets. Under current law, however, sales of our ordinary shares are exempt from Israeli capital gains tax for so long as the shares are quoted on Nasdaq or listed on a stock exchange recognized by the Israeli Ministry of Finance, provided that we continue to qualify as an "industrial company" or "industrial holding company." See - "Tax Benefits under the Law for the Encouragement of Industry (Taxes), 1969." Furthermore, under the Israeli-U.S. Treaty, a holder of ordinary shares who is a U.S. resident will generally be exempted from Israeli capital gain tax on the sale of ordinary shares unless such holder owned, directly or indirectly, 10% or more of our voting power at any time during the 12-month period before the sale.

A non-resident of Israel who receives interest, dividend or royalty income derived from or accrued in Israel, from which tax was withheld at the source, is generally exempted from the duty to file tax returns in Israel with respect to such income, provided such income was not derived from a business conducted in Israel by the taxpayer and the taxpayer has no other taxable sources of income in Israel.

Israel presently has no estate or gift tax.

Reform of Income Taxes in Israel

On July 24, 2002, Amendment 132 to the Israeli Tax Ordinance (the "Amendment") was approved by the Israeli parliament and came into effect on January 1, 2003. The principal

objectives of the amendment were to broaden the categories of taxable income and to reduce the tax rates imposed on employees' income.

The material consequences of the amendment applicable to our company include, among other things, imposing a tax upon all income of Israeli residents, individuals and corporations, regardless of the territorial source of the income and certain modifications in the qualified taxation tracks of employee stock options. In addition, a foreign tax credit was introduced, allowing us to credit the income tax paid by our subsidiaries abroad against our tax liabilities on dividends paid to us by such subsidiaries.

United States Federal Income Tax Consequences

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

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

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

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

be treated as a U.S. person.

Taxation of Dividends

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

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

Any Israeli withholding tax imposed on such dividends will be a foreign income tax eligible for credit against a U.S. Holder's U.S. federal income tax liability, subject to certain limitations set out in the Code (or, alternatively, for deduction against income in determining such tax liability). The limitations set out in the Code include computational rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income taxes otherwise payable with respect to each such class of income (see "-New Tax Law Applicable to Dividends and Long-Term Capital Gain," below). Dividends generally will be treated as foreign-source passive income or financial services income for United States foreign tax credit purposes. Foreign income taxes exceeding the credit limitation for the year of payment or accrual may be carried back for two taxable years and forward for five taxable years in order to reduce U.S. federal income taxes, subject to the credit limitation applicable in each of such years. Other restrictions on the foreign tax credit include a prohibition on the use of the credit to reduce liability for the U.S. individual and corporation alternative minimum taxes by more than 90%. A U.S. Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on the ordinary shares to the extent such U.S. Holder has not held the ordinary shares for at least 16 days of the 30-day period beginning on the date which is 15 days before the ex-dividend date or to the extent such U.S. Holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a U.S. Holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the 16-day holding

period required by the statute. The rules relating to the determination of the foreign tax credit are complex, and you should consult with your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

Disposition of Ordinary Shares

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

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

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

New Tax Law Applicable to Dividends and Long-Term Capital Gain

Under recently enacted amendments to the Code, dividends received by noncorporate U.S. Holders from certain foreign corporations, and long-term capital gain realized by noncorporate U.S. Holders, generally are subject to U.S. federal income tax at a reduced maximum tax rate of 15 percent through December 31, 2008. Dividends received with respect to ordinary shares should qualify for the 15 percent rate. The rate reduction does not apply to dividends received from PFICs, see discussion below, or in respect of certain short-term or hedged positions in common stock or in certain other situations. The legislation enacting the reduced tax rate contains special rules for computing the foreign tax credit limitation of a taxpayer who receives dividends subject

to the rate reduction. U.S. Holders of ordinary shares should consult their own tax advisors regarding the implications of these rules in light of their particular circumstances.

Passive Foreign Investment Companies

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

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

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

- you would be required to allocate income recognized upon receiving certain dividends or gain recognized upon the disposition of ordinary shares ratably over the holding period for such ordinary shares,
- the amount allocated to each year during which we are considered a PFIC other than the year of the dividend payment or disposition would be subject to tax at the highest individual or corporate tax rate, as the case may be, in effect for that year and an interest charge would be imposed with respect to the resulting tax liability allocated to each such year,
- gain recognized upon the disposition of ordinary shares would be taxable as ordinary income, and
- you would be required to make an annual return on IRS Form 8621 regarding distributions received with respect to ordinary shares and any gain realized on your ordinary shares.

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

distributed to you. You would not be eligible to make a QEF election unless we comply with certain applicable information reporting requirements.

Alternatively, if the ordinary shares are considered "marketable stock" and if you elect to "mark-to-market" your ordinary shares, you will generally include in income any excess of the fair market value of the ordinary shares at the close of each tax year over your adjusted basis in the ordinary shares. If the fair market value of the ordinary shares had depreciated below your adjusted basis at the close of the tax year, you may generally deduct the excess of the adjusted basis of the ordinary shares over its fair market value at that time. However, such deductions generally would be limited to the net mark-to-market gains, if any, that you included in income with respect to such ordinary shares in prior years. Income recognized and deductions allowed under the mark-to-market provisions, as well as any gain or loss on the disposition of ordinary shares with respect to which the mark-to-market election is made, is treated as ordinary income or loss.

Backup Withholding and Information Reporting

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

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

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

U.S. Gift and Estate Tax

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

F. DIVIDEND AND PAYING AGENTS

Not applicable.

G. STATEMENT BY EXPERTS

Not applicable.

H. DOCUMENTS ON DISPLAY

We are subject to the reporting requirements of the United States Securities Exchange Act of 1934, as amended, as applicable to "foreign private issuers" as defined in Rule 3b-4 under

the Exchange Act, and in accordance therewith, we file annual and interim reports and other information with the Securities and Exchange Commission.

As a foreign private issuer, we are exempt from certain provisions of the Exchange Act. Accordingly, our proxy solicitations are not subject to the disclosure and procedural requirements of Regulation 14A under the Exchange Act, transactions in our equity securities by our officers and directors are exempt from reporting and the "short-swing" profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file periodic reports and financial statements as frequently or as promptly as United States companies whose securities are registered under the Exchange Act. However, we distribute annually to our shareholders an annual report containing financial statements that have been examined and reported on, with an opinion expressed by, an independent public accounting firm, and we intend to file reports with the Securities and Exchange Commission on Form 6-K containing unaudited financial information for the first three quarters of each fiscal year.

This annual report and the exhibits thereto and any other document we file pursuant to the Exchange Act may be inspected without charge and copied at prescribed rates at the following Securities and Exchange Commission public reference rooms: 450 Fifth Street, N.W., Judiciary Plaza, Room 1024, Washington, D.C. 20549; and on the Securities and Exchange Commission Internet site (http://www.sec.gov) and on our website www.rada.com. You may obtain information on the operation of the Securities and Exchange Commission's public reference room in Washington, D.C. by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Exchange Act file number for our Securities and Exchange Commission filings is 0-30198.

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

I. SUBSIDIARY INFORMATION

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS

Interest Rate Risk

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

A devaluation of the NIS in relation to the U.S. dollar has the effect of reducing the U.S. dollar amount of any of our expenses or liabilities which are payable in NIS (unless such

expenses or payables are linked to the U.S. dollar). As of December 31, 2003, we had liabilities payable in NIS which are not linked to the U.S. dollar in the amount of $2.5 million and cash and receivables in the amount of $700,000 denominated in NIS. Accordingly, an increase of 1% of the NIS against the dollar would increase our financing expenses by approximately $18,000. A devaluation of 1% of the NIS against the dollar would decrease our financing expenses by the same amount. However, the amount of liabilities payable and/or cash and receivables in NIS is likely to change from time to time.

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

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

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

None.

ITEM 15. CONTROLS AND PROCEDURES

During the year 2003, we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our company's disclosure controls and procedures pursuant to Rule 13a-14 of the Securities Exchange Act of 1934. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our company's disclosure controls and procedures are effective in timely alerting them to material information relating to our company required to be included in our company's periodic SEC filings.

There have been no significant changes in our internal controls or other factors which could significantly affect internal controls subsequent to the date we carried out the evaluation.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems,

there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

ITEM 16. RESERVED.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors has determined that Mr. Zvi Trop, one of our outside directors, meets the definition of an audit committee financial expert, as defined in Item 401 of Regulation S-K.

ITEM 16B. CODE OF ETHICS

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

ITEM 16C. PRINCIPAL ACCOUNTING FEES AND SERVICES

Fees Paid to Independent Public Accountants

The following table sets forth, for each of the years indicated, the fees paid to our independent public accountants and the percentage of each of the fees out of the total amount paid to the accountants.

	Year Ended December 31,			
	2002		2003	
Services Rendered	Fees	Percentages	Fees	Percentages
Audit	$50,000	95%	$50,000	100%
Audit-related	$2,500	5%	-	-
Tax	-	-	-	-
Other.....	-	-	-	-
Total	$52,500	100%	$50,000	100%

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 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. 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 SEC, and also requires the Audit Committee to consider whether proposed services are compatible with the independence of the public accountants.

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

Not applicable.

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

Issuer Purchase of Equity Securities

Neither we, nor any "affiliated purchaser" of our company, has purchased any of our securities during 2003.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

Consolidated Financial Statements

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ITEM 19. EXHIBITS

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Exhibit	Description
3.1*	Memorandum of Association of the Registrant
3.2*	Articles of Association of the Registrant
4.1*	Specimen of Share Certificate
10.1*	1993 Employee Stock Option Plan, as amended
10.2*	1994 Employee Stock Option Plan, as amended
10.3*	1996 Employee Stock Option Plan, as amended
10.4*	1999 Employee Stock Option Plan, as amended
10.5***	2003 Employee Stock Option Plan, as amended
10.6*	Form of warrants to directors
10.7*	Loan Agreement dated June 3, 2001 between the Registrant and Mr. Howard Yeung
10.8*	Deed of Termination of Joint Venture Agreement dated June 3, 2001, effective as of January 1, 2000 and Agreement for the acquisition of part of the issued share capital of New Reef Holding Ltd. dated June 3, 2001
10.11***	Memorandum of Agreement dated June 23 2003 between the Registrant and Bank Hapoalim B.M. and Bank Leumi Le-Israel B.M.
21	List of Subsidiaries of the Registrant
23.1	Consent of Kost Forer Gabbay & Kasierer, a Member of Ernst & Young Global, Certified Public Accountants (Israel) with respect to our Registration Statements on Form F-3 and S-8
23.2	Consent of Luboshitz Kasierer, a Member of Ernst & Young Global, Certified Public Accountants (Israel) with respect to our Registration Statements on Form F-3 and S-8

31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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

** Filed as an exhibit to our Annual Report on Form 20-F for the year ended December 31, 2001 and incorporated herein by reference.

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

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2003

IN U.S. DOLLARS

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ERNST & YOUNG

REPORT OF INDEPENDENT AUDITORS

To the Shareholders of

RADA ELECTRONIC INDUSTRIES LTD.

We have audited the accompanying consolidated balance sheet of Rada Electronic Industries Ltd. and its subsidiary (the "Company") as of December 31, 2003 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 as of December 31, 2003, and the results of their operations and cash flows for the year then ended, 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 31, 2004

REPORT OF INDEPENDENT AUDITORS

To the Shareholders of
RADA ELECTRONIC INDUSTRIES LTD.

We have audited the accompanying consolidated balance sheet of Rada Electronic Industries Ltd. and its subsidiaries ("the Company") as of December 31, 2002 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the year ended December 31, 2002. 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. The financial statements of Rada Electronic Industries Ltd. as of December 31, 2001 and for the year ended December 31, 2001 were audited by other auditors who have ceased operations as a foreign associated firm of the Securities and Exchange Commission Practice Section of the American Institute of Certified Public Accountants and whose report dated April 28, 2002, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards required that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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, 2002, and the results of

their operations and cash flows for the year ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

/s/ Luboshitz Kasierer
Luboshitz Kasierer
An affiliate member of Ernst & Young International

Tel-Aviv, Israel

June 23, 2003

This is a copy of the previously issued Independent Public Accountants' report of Arthur Andersen. The report has not been reissued by Arthur Andersen.

To the Shareholders of
RADA ELECTRONIC INDUSTRIES LTD.

We have audited the accompanying consolidated balance sheets of Rada Electronic Industries Ltd. and its subsidiaries (the "Company") as of December 31, 2001 and 2000 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2001. 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 auditing standards generally accepted in the 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as 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, 2001 and 2000, and the results of its operations and cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

Tel-Aviv, Israel
April 28, 2002

Luboshitz Kasierer
Arthur Andersen

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
U.S. dollars in thousands, except share and per share data

	Note	December 31, 2003	20
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents		$ 467	$
Trade receivables (net of allowance for doubtful accounts of $ 214 at December 31, 2003 and 2002)		3,496	1
Other receivables and prepaid expenses		250	
Costs and estimated earnings in excess of billings on uncompleted contracts	3	176	
Inventories	4	873	1
Total current assets		5,262	3
LONG-TERM RECEIVABLES AND DEPOSITS:			
Long-term receivables	5	990	
Leasing deposits		71	
Severance pay fund		1,511	1
Total long-term receivables and deposits		2,572	2
PROPERTY AND EQUIPMENT, NET	6	4,728	5
INTANGIBLE ASSETS, NET	7	1,987	3
Total assets		$ 14,549	$ 14
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Short-term bank credit and loans	8	$ 1,123	$ 5
Trade payables		640	
Other payables and accrued expenses	9	3,317	2
Deferred revenues		1,062	1
Billings in excess of costs and estimated earnings on uncompleted contracts	3	1,836	
Total current liabilities		7,978	11
LONG-TERM LIABILITIES:			
Long-term loans	8	1,220	

Accrued severance pay		2,048	2
Total long-term liabilities		3,268	2
CONTINGENCIES, COMMITMENTS AND CHARGES	10		
MINORITY INTERESTS		425	
SHAREHOLDERS' EQUITY:	11		
Share capital			
Ordinary shares of NIS 0.005 par value - Authorized: 45,000,000 shares at December 31, 2003 and 2002; Issued and outstanding: 18,510,716 shares at December 31, 2003 and 2002		108	
Additional paid-in capital		59,139	58
Warrants		1,405	
Accumulated deficit		(57,774)	(58
Total shareholders' equity		2,878	
Total liabilities and shareholders' equity		$ 14,549	$ 14

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

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands, except share and per share data

		Year ended December 31,		
	Note	2003	2002	
Revenues:	14,15			
Products		$ 8,977	$ 6,773	$ 5
Services		3,338	3,626	2
		12,315	10,399	8
Cost of revenues:	14			
Products		6,933	6,685	6
Services		2,659	2,538	1
		9,592	9,223	7
Gross profit		2,723	1,176	

Operating expenses:				
Research and development expenses		-	122	
Marketing, selling, general and administrative expenses		2,698	3,089	3
Total operating expenses		2,698	3,211	4
Operating income (loss)		25	(2,035)	(3
Financial income (expenses), net	13a,14	708	(364)	
Other expenses, net	13b	(2)	(290)	
		731	(2,689)	(3
Minority interests in losses of subsidiary		27	206	
Net income (loss)		$ 758	$ (2,483)	$ (3
Earnings (loss) per share:				
Basic net earnings (loss) per share	16	$ 0.04	$ (0.15)	$ (
Diluted net earnings (loss) per share	16	$ 0.04	$ (0.15)	$ (

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

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES
STATEMENTS OF CHANGES IN SHARHOLDERS' EQUITY

U.S. dollars in thousands, except share data

	Number of Ordinary shares	Share capital	Additional paid-in capital	Warrants	Accumulated deficit	Tota shareho equit
Balance at January 1, 2001	13,816,839	$ 103	$56,646	$ -	$(52,680)	$ 4,0
Net loss	-	-	-	-	(3,369)	(3,3
Balance at December 31, 2001	13,816,839	103	56,646		(56,049)	7
Issuance of Ordinary						

shares and warrants, net *)	1,938,775	2	792	41	-	8
Conversion of loan into Ordinary shares and warrants	2,755,102	3	1,347	83	-	1,4
Net loss	-	-	-	-	(2,483)	(2,4
Balance at December 31, 2002	18,510,716	108	58,785	124	(58,532)	4
Adjustment of accrual for issuance expenses	-	-	354	-	-	3
Fair value of warrants issued in connection with settlement of debt, net *)	-	-	-	1,267	-	1,2
Fair value of warrants issued to suppliers	-	-	-	14	-	
Net income	-	-	-	-	758	7
Balance at December 31, 2003	18,510,716	$ 108	$59,139	$1,405	$(57,774)	$ 2,8

*) Net of issuance expenses of approximately $ 38 and $ 115 in the years ended December 31, 2003 and 2002, respectively.

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

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2003	2002	200
Cash flow from operating activities:			
Net income (loss)	$ 758	$ (2,483)	$ (3,
Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Loss (gain) on extinguishment of debt	(1,013)	83	
Depreciation and amortization	2,072	2,388	1,
Provision of long-term receivable	-	290	
Loss on sale of a subsidiary	-	-	
Stock compensation expense - fair value of warrants issued to suppliers	14	-	
Minority interests in losses of subsidiary	(27)	(206)	
Accrued interest and translation differences on long-term receivables	(97)	(40)	

Decrease (increase) in trade receivables, net	(1,664)	(1,015)	
Decrease (increase) in other receivables and prepaid expenses	(157)	(26)	
Decrease in inventories	204	539	
Decrease in costs and estimated earnings in excess of billings, net	1,085	460	
Increase (decrease) in trade payables	5	(162)	(
Increase (decrease) in other payables and accrued expenses	722	63	
Decrease in deferred revenues	(709)	(592)	
Accrued severance pay, net	(172)	276	
Others	-	-	
Net cash provided by (used in) operating activities	1,021	(425)	(
Cash flow from investing activities:			
Purchase of property and equipment	(49)	(85)	(
Proceeds from sale of property and equipment	-	94	
Capitalization of software development costs	-	-	(
Grant of loans to employees	-	-	
Repayment of loans granted to employees	-	20	
Sale of a subsidiary, net of cash (a)	-	-	
Payment of leasing deposits	(1)	(70)	
Net cash used in investing activities	(50)	(41)	(
Cash flow from financing activities:			
Proceeds from issuance of shares, net	-	835	
Increase (decrease) in short-term bank credits and loans, net	(1,074)	(223)	
Proceeds from issuance of loan to a related party	-	550	1,
Repayment of loan to a related party	-	(200)	
Net cash provided by (used in) financing activities	(1,074)	962	1,
Increase (decrease) in cash and cash equivalents	(103)	496	
Cash and cash equivalents at the beginning of the year	570	74	
Cash and cash equivalents at the end of the year	$ 467	$ 570	$

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

U.S. dollars in thousands

	Year ended December 31,		
	2003	2002	2001
Non-cash transactions:			
Conversion of shareholder's loan into Ordinary shares and warrants	$ -	$ 1,350	$
Fair value of warrants issued in connection with settlement of debt	$ 1,305	$ -	$
Adjustment of accrual for issuance expenses	$ 354	$ -	$
Supplemental disclosures of cash flow activities:			
Net cash paid during the year for:			
Income taxes	$ 5	$ 7	$
Interest	$ 240	$ 326	$

(a) Sale of a subsidiary (Jetborne):

Working capital (excluding cash and cash equivalents)	$
Property and equipment	
Long-term assets	
Minority interest	
Loss on realization	
Long-term receivable	
	-
	$
	=

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

U.S. dollars in thousands

NOTE 1:- GENERAL

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

b. As reflected in the consolidated financial statements, as of December 31, 2003, the Company had an accumulated deficit of $ 57,774 and a working capital deficiency of $ 2,716. During 2003, the Company entered into a restructuring agreement with its banks with respect to $ 3,451 of its debt and recorded a gain on restructuring of approximately $ 1,000 (see Note 11c). Subsequent to balance sheet date, one of its banks also agreed to extend the payment terms of a short-term loan and, as a result, approximately $ 1,200 of the loan was reclassified to long-term debt. Management believes that the abovementioned agreement and the anticipated cash flows from operations will enable the Company to finance its operations at least through December 31, 2004.

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

d. The Company sold aircraft spare parts through Jetborne International, Inc. ("Jetborne"), which was 75% owned by the Company until December 31, 2001. Jetborne historically purchased inventory in bulk, mainly at auctions, and sold the spare parts over long periods of time through a computerized communication system through which sales and purchases of airplanes spare parts are effected. In March 2002, the Company sold its 75% equity interest in Jetborne in consideration for one dollar and recorded a loss of $30. Jetborne's results of operations for the year ended December 31, 2001 are included in the consolidated statement of operations (see Note 5).

e. As for major customers, see Note 15.

f. The Company changed the estimated useful life of the remaining intangible assets associated with its Aircraft Test Systems Programs Sets ("TPS"s) from five to ten years. The effect of change in estimate on the net income and net earnings per share for the year ended December 31, 2003, resulted in a decrease of $136 and $0.01, respectively. The annual expected effect of this change of estimate for the following years resulted in a decrease of approximately $116 and $0.01 on net income and on net earnings per share, respectively.

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

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

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

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

Accordingly, monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars in accordance with Statement of the Financial Accounting Standard Board No. 52 "Foreign Currency Translation" ("SFAS No. 52"). All transaction gains and losses of the remeasured monetary balance sheet items are reflected in the statement of operations as financial income or expenses, as appropriate. The representative exchange rate at December 31, 2003 was U.S. $ 1.00 = NIS 4.379.

c. Basis of consolidation:

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

d. Cash equivalents:

All highly liquid investments that are readily convertible to cash and are not restricted with original maturity of three months or less are considered cash equivalents.

e. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs are provided to cover risks arising from slow-moving items, excess inventories, and for market prices lower than cost. As for write-offs included in these financial statements, see Note 4.

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Cost is determined as follows:

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

Work in progress - represents the cost of manufacturing with the addition of allocable indirect manufacturing costs. Costs of work in progress is determined as follows: raw materials - as mentioned above and manufacturing costs on an average basis.

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

f. Intangible assets:

Capitalized software costs are amortized by the greater of the amount computed using the: (i) ratio that current gross revenues from sales of the software to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the product. The Company assesses the recoverability of these intangible assets on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold. As for impairment charges included in these financial statements, see Note 7.

g. Property and equipment:

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

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

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

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

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

h. Impairment of long-lived assets:

The Group's long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Recoverability of an asset 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 asset. If such asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. As for write-down charges included in these financial statements, see Note 6.

i. Research and development costs:

Statement of Financial Accounting Standards No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed," ("SFAS No. 86") requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon completion of a working model.

Research and development costs incurred in the process of developing product masters, product enhancements and the Company's TPS software library, integrated with the Company's test station, are generally charged to expenses as incurred.

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

j. Income taxes:

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Severance pay:

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

Severance expense recorded in the statement of operations is net of interest and other income accumulated in the deposits. Severance expense for the years ended December 31, 2003, 2002 and 2001 amounted to $132, $541 and $194, respectively.

l. Fair value of financial instruments:

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

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

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

m. Concentrations of credit risk:

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

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

The Company's trade receivables are derived from sales to large and solid organizations located mainly in the United States,

Europe and Israel. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to these amounts that the Company has determined to be doubtful of collection. The allowance is computed for specific debts and the collectibility is determined based upon the Company's experience.

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company granted loans in prior years to its former CEO and a former officer amounting to approximately $983 and $890 including interest as of December 31, 2003 and 2002, respectively. These loans are unsecured and the Company is currently in litigation with its former CEO and a former officer regarding such loans. If not paid, the Company will incur a loss equal to the amount of the loans.

The Company has no off-balance sheet credit risks.

n. Warranty:

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

o. Share based compensation:

The Company accounts for stock option grants in accordance with Accounting Principles Board Opinion No. 25 - "Accounting for Stock Based Compensation" ("APB No. 25") and FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44"). According to APB No. 25, compensation expense is measured under the intrinsic value method, whereby compensation expense is equal to the excess, if any of the quoted market price of the share at the date of grant of the award over the exercise price. The Company provides the disclosures required by Statement of Financial Accounting Standard No. 123 "Accounting for Stock-Based Compensation" ("SFAS No. 123") and FAS No. 148 "Accounting for Stock-Based Compensation - Transition and disclosure" ("SFAS 148").

The Company adopted the disclosure provisions of Financial Accounting Standards Board Statement No. 148, "Accounting for Stock-Based Compensation - transition and disclosure" ("SFAS No. 148"), which amended certain provisions of SFAS 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation, effective as of the beginning of the fiscal year. The Company continues to apply the provisions of APB No. 25, in accounting for stock-based compensation.

Pro forma information regarding the Company's net income (loss) and net earnings (loss) per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123.

The fair value for these options was estimated at the date of grant, using the Black and Scholes Option Valuation Model, with the following weighted-average assumptions for each of the three years in the period ended December 31, 2003: (1) expected life of option of two years; (2) dividend yield of 0%; (3) expected volatility of 31% (24% - 2002, 36% - 2001); and (4) risk-free interest rate of 1% (2% -2002, 5% - 2001). The compensation expense is amortized over the vesting period of the options.

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

If deferred compensation had been determined under the above mentioned fair value method, the effect on the Company's share based compensation cost, net income (loss) and net earnings (loss) per share would have been immaterial for all the reported periods.

The Company applies SFAS No. 123 and Emerging Issues Task Force No. 96-18 "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" ("EITF 96-18"), with respect to options and warrants issued to non-employees. SFAS No. 123 requires the use of option valuation models to measure the fair value of the options and warrants at the date of grant.

p. Revenue recognition:

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

Product revenues:

In December 2003, the SEC issued Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition" ("SAB No. 104") which revises or rescinds certain sections of SAB No. 101 "Revenue Recognition," in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on the Company's consolidated results of operations, consolidated financial position or consolidated cash flows.

Revenues from sales of products and aircraft spare parts are recognized in accordance with SAB 104, according to which revenue is recognized when shipment has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no further obligation remains and collectibility is probable.

Revenues from certain long-term fixed price contracts are recognized in accordance with Statement of Position No. 81-1 "Accounting for Performance of Construction - Type and Certain Production - Type Contracts" ("SOP 81-1"), using contract accounting on a percentage of completion method. The percentage of completion is determined based on the ratio of actual costs incurred to total costs estimated to be incurred over the duration of the contract. With regard to contracts for which a loss is anticipated, a provision is made for the entire amount of the estimated loss at the time such loss becomes evident. As of December 31, 2003, no such estimated losses were identified. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

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

In November 2002, Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables". EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF Issue No. 00-21 applied to revenue arrangements entered into in fiscal periods beginning after June

15, 2003. Additionally, companies will be permitted to apply the consensus guidance in this issue to all existing arrangements as the cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20, "Accounting Changes". EITF Issue No. 00-21 also addresses how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement.

Revenues from certain arrangements may include multiple elements within a single contract. The Company's accounting policy complies with the revenue determination requirements set forth in EITF 00-21, relating to the separation of multiple deliverables into individual accounting units with determinable fair values. The Company's arrangements are accounted for as one unit of accounting.

Service revenues:

Revenues from services are recognized as the services are performed.

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

Deferred revenues include unearned amounts received under services contracts, and amounts received from customers but not yet recognized as revenues.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

Basic net earnings (loss) per share is computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net income (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year in accordance with statement of Financial Accounting Standards No. 128, "Earnings Per Share". Options and warrants to purchase 14,862,237, 13,718,037 and 2,359,894 Ordinary shares have been excluded from the computation of diluted net loss per share for the years ended December 31, 2003, 2002 and 2001, respectively, because their effect is anti-dilutive for all periods presented.

r. Recently issued accounting pronouncements:

In January 2003, the Financial Accounting Standards Board (FASB)

issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). In December 2003, the FASB modified FIN 46 to make certain technical corrections and address certain implementation issues that had arisen. FIN 46 provided a new framework for identifying variable interest entities (VIEs) and determining when a company should include the assets, liabilities, noncontrolling interests and results of activities of a VIE in its consolidated financial statements.

In general, a VIE is a corporation, partnership, limited-liability corporation, trust or any other legal structure used to conduct activities or hold assets that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that are unable to make significant decisions about its activities, or (3) has a group of equity owners that do not have the obligations to absorb losses or the right to receive returns generated by its operations.

FIN 46 requires a VIE to be consolidated if a party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) is obligated to absorb a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party absorbs a majority for the VIE's losses) or both. A variable interest holder that consolidates the VIE is called the primary beneficiary. Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and noncontrolling interests at fair value and subsequently account for the VIE as if it were consolidated based on a majority voting interest. FIN 46 also requires disclosures about VIEs that the variable interest holder is no required to consolidate but in which it has a significant variable interest. The Company will apply the provisions of FIN 46 as of March 31, 2004. As of December 31, 2003, the Company does not expect the adoption of FIN 46 to have a material impact on its consolidated financial statements.

U.S. dollars in thousands

NOTE 3:- CONTRACTS IN PROGRESS

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

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

	December 31,

	2003	2002
Costs incurred on uncompleted contracts	$ 862	$ -
Estimated earnings	324	-
	1,186	-
Less - billings and progress payments	1,010	-
	$ 176	$ -

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

	December 31,	
	2003	2002
Costs incurred on uncompleted contracts	$ 3,711	$ 1,453
Estimated earnings	1,019	756
	4,730	2,209
Less - billings and progress payments	6,566	2,784
	$ 1,836	$ 575

NOTE 4:- INVENTORIES

	December 31,	
	2003	2002
Raw materials and components	$ 668	$ 713
Work in progress	112	364
Finished goods	93	-
	$ 873	$1,077

Write-down of inventories for the years ended December 31, 2003, 2002 and 2001 amounted to $0, $623 and $0 respectively. The write-off in 2002 was for excess and slow moving inventories and was included in cost of revenues.

NOTE 5:- LONG-TERM RECEIVABLES

	December 31,

	2003	2002
Loan to former chief executive officer (1)	$ 705	$ 636
Loan to a former officer (1)	278	251
Loan to Jetborne (2)	290	290
Loans to employees	7	6
	1,280	1,183
Less - allowance for doubtful accounts (2)	(290)	(290)
	$ 990	$ 893

(1) The loans to the former officers are in New Israeli Shekels linked to the Israeli Consumer Price Index ("CPI") and bear interest of 4% per annum. The loans were granted from 1989 through 1997. The Company is currently in litigation with its former CEO and the former officer - see Note 10a.

(2) Loan to Jetborne - On December 31, 2001, the Company sold its 75% ownership in Jetborne in consideration for one dollar. Jetborne will repay the Company the outstanding loan, including accrued interest within ten years from the date of the agreement. In addition, Jetborne is committed to pay the Company royalties as a percentage of the gross revenues of Jetborne, which are derived from the inventory held by Jetborne as of December 31, 2001. It was agreed that any payments on account of the royalties will be deducted from the outstanding loan. In any event, the loan should be repaid no later than the tenth anniversary of the agreement. The outstanding loan is presented at an estimated discounted fair value of $290, net of a provision recorded for the entire amount of the outstanding loan, due to doubt of collectibility (see Note 13b).

U.S. dollars in thousands

NOTE 6:- PROPERTY AND EQUIPMENT, NET

	December 31,	
	2003	2002
Cost:		
Factory building	$ 1,940	$ 1,940
Other building	1,042	1,042
Machinery and equipment	13,044	12,996
Office furniture and equipment	459	458
Leasehold improvements	20	20
	16,505	16,456
Accumulated depreciation:		

Factory building	1,132	1,061
Other building	175	130
Machinery and equipment	10,145	9,365
Office furniture and equipment	305	278
Leasehold improvements	20	11
	11,777	10,845
Depreciated cost	$ 4,728	$ 5,611

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

Depreciation expense was $932, $918 and $1,103 for the years ended December 31, 2003, 2002 and 2001, respectively. Write-down of property and equipment, which is not in use by the Company, was $0, $490 and $200 for the years ended December 31, 2003, 2002 and 2001, respectively. The write-downs were included in cost of revenues.

As for charges, see Note 10e.

NOTE 7:- INTANGIBLE ASSETS, NET

	December 31,	
	2003	2002
Test Systems Programs Sets:		
Cost	$ 8,275	$ 8,275
Less - accumulated amortization	6,288	5,148
Amortized cost	$ 1,987	$ 3,127

U.S. dollars in thousands

NOTE 7:- INTANGIBLE ASSETS, NET (Cont.)

Amortization expense was $382, $730 and $607 for the years ended December 31, 2003, 2002 and 2001, respectively. The expected amortization expense in the next five years is approximately as follows:

2004	$ 275
2005	275
2006	275
2007	275
2008	177
	$1,277

Impairment of intangible assets was $758, $251 and $51 for the years ended December 31, 2003, 2002 and 2001, respectively included in cost of revenues. The impairment was recorded since the Company did not anticipate future revenues on specific TPSs. The weighted average useful life of the intangible assets is eight years.

NOTE 8:- LOANS AND SHORT-TERM BANK CREDIT

	December 31,	
	2003	2002
Short-term:		
Current maturities of long-term loan in U.S. dollars (1)	$ 180	$ 3,965
Short-term bank loan in U.S. dollars (2)	-	1,000
Short-term bank credits in NIS (3)	943	732
	$ 1,123	$ 5,697
Long-term:		
Loans in U.S. dollars (1)	$ 1,220	$ -

The loans mature as follows:

December 31,	
2004 (current maturity)	
2005	$ 180
2006	420
	800
	$ 1,400

(1) The interest rate at December 31, 2003 is between 4.25%-5.13% (December 31, 2002 between 2.4% - 4.9%). The weighted average interest rate as of December 31, 2003 is 4.25 % (December 31, 2002 - 4.6%).

(2) The interest rate at December 31, 2002 is 4.4%.

(3) The interest rate at December 31, 2003 is 8% (December 31, 2002 - 11.4%).

NOTE 8:- LOANS AND SHORT-TERM BANK CREDIT (Cont.)

During 2003, the Company restructured a portion of its debt with its banks (see Note 11c). In addition, subsequent to balance sheet date, one of the banks agreed to extend the payment terms of a short-term loan of $1,400 to 2006. As a result, $1,220 of the loan was reclassified to long-term debt.

The total authorized credit line of the Company at December 31, 2003 is $1,285 (of which $943 was utilized).

As for collateral, see Note 10e.

NOTE 9:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	December 31,	
	2003	2002
Payroll and related accruals	$ 860	$ 940
Provision for legal proceedings	748	594
Accrued royalties	644	662
Accrued commissions	491	-
Other	574	753
	$ 3,317	$ 2,949

NOTE 10:- CONTINGENCIES, COMMITMENTS AND CHARGES

a. As of December 31, 2003, the Company was a party to various legal proceedings, including the following:

1. In June 1998, the Company's Board of Directors accepted the resignation of the Company's former CEO. In December 1998, the former CEO commenced legal proceedings against the Company in the Tel Aviv Labor Court, claiming approximately $ 500 in respect of salary, severance pay, vacation pay and other fringe benefits. The former CEO also claimed that a personal loan that was provided to him by the Company had been forgiven. In May 2001, an additional claim of approximately $ 230 was filed by the former CEO against the Company in the Tel-Aviv District Court for damages allegedly caused to him as a result of attachment imposed on certain of his assets by the Company that was subsequently cancelled by the Court. In addition, in 2001, the Company filed a claim against a former director in event the former CEO's claim in the Labor Court is accepted by the court, damages in the amount of $ 250 should be covered by the former director. The Company filed additional lawsuits against the former CEO and a former director in the amount of $ 250 for funds that they allegedly transferred from the Company to a third party. In September 1999 and in 2001, the Company filed lawsuit against the former CEO and the former director with the District Court of Tel Aviv in the amount of $ 1,400 for damages caused to the Company in the purchase of a subsidiary and negligence of management. In August 2000, the Company filed an additional lawsuit against the former CEO in the amount of approximately $ 460 regarding the repayment of the loan provided to the former CEO. Legal counsel

believes that the Company has a valid defense against all claims made against it.

U.S. dollars in thousands, except share and per share data

NOTE 10:- CONTINGENCIES, COMMITMENTS AND CHARGES (Cont.)

2. In 1999 and 2000, the former CEO and his son filed a number of complaints against the Company's president and are seeking damages for alleged slander by the defendant in the amount of approximately $750. In the opinion of Company's legal counsel, the Company has a strong defense against the allegations.

3. In 2000, a former employee and officer of the Company filed a claim against the Company with the Tel Aviv Labor Court claiming approximately $580 in respect of severance pay, vacation pay and other fringe benefits. In 2001, the Company filed a counter-claim in the amount of $300 in respect of the repayment of a personal loan that was provided to the former employee. In the opinion of the Company's legal counsel, the Company has a strong defense against the allegations.

4. In 2001, a former director filed a claim against the Company, whereby he claims that he is entitled to 600,000 options to purchase Ordinary shares of the Company. Legal counsel believes that the claim does not have any merit.

5. In 2002, a claim was filed against the Company, whereby an individual claims that it served as an agent in an agreement signed between the Company and a customer and is entitled to commissions in the amount of $250. In the opinion of Company's legal counsel, the Company has a strong defense against the allegations.

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

b. The Company's research and development efforts have been partially financed through royalty bearing programs sponsored by the Office of the Chief Scientist of the Ministry of Industry and Trade of Israel ("OCS"). In return for the OCS's participation, the Company is committed to pay royalties at a rate ranging from 3 % to 5% of sales of the products supported by the OCS, up to 100% of the amount of such participation received linked to the

U.S. dollar. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, no payment is required. The Company's total obligation for royalties, net of royalties paid or accrued totaled approximately $630 as of December 31, 2003.

The total amount of royalties charged to operations in the years ended December 31, 2003, 2002 and 2001 was approximately $73, $98 and $153, respectively.

U.S. dollars in thousands, except share and per share data

NOTE 10:- CONTINGENCIES, COMMITMENTS AND CHARGES (Cont.)

c. Research and development projects undertaken by the Company were partially financed by the Binational Industrial Research and Development Fund ("BIRD") Foundation. The Company is committed to pay royalties to the BIRD Foundation at a rate of 2.5% of sales proceeds generating from projects for which the BIRD Foundation provided funding up to 150% of the sum financed by the BIRD Foundation. The Company's total obligation for royalties, net of royalties paid or accrued, totaled approximately $1,890 as of December 31, 2003. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, no payment is required.

The total amount of royalties charged to operations for the years ended December 31, 2003, 2002 and 2001 was approximately $15, $13 and $13, respectively.

d. The Netanya offices of the Company are rented under a non-cancelable operating lease expiring by January 31, 2005. In addition, certain of the Company's vehicles and computers are under operating leases. Annual minimum future rental payments under these leases, at exchange rates in effect on December 31, 2003, are approximately as follows:

2004	$ 505
2005	192
2006	20
	$ 717

Lease expense for the years ended December 31, 2003, 2002 and 2001 was $447, $277 and $195, respectively.

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

f. The Company obtains bank guarantees on behalf of its customers and suppliers in the ordinary course of business. The total amount of bank guarantees as of December 31, 2003 is

approximately $3,458.

NOTE 11:- SHAREHOLDERS' EQUITY

a. Share capital:

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

In June 2002, the Company issued 1,938,775 Ordinary shares in a private placement to certain investors in consideration for an aggregate amount of $950 ($835, net of issuance expenses). The shares were issued at a 30% discount from the Ordinary share price on Nasdaq at the date of issuance, which is deemed to be the fair value of a "restricted" Ordinary share. See c. below for warrants issued to investors.

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

In June 2002, the Company issued 2,755,102 Ordinary shares in a private placement to a shareholder in consideration for conversion of a loan that was given to the Company in the amount of $1,350. The shares were issued at the same price as the shares issued in the 2002 private placement described above. See c. below for warrants issued to a shareholder.

In March 2001, the Company effected a 2.5 to 1 reverse stock split with respect to its Ordinary shares. All shares, stock options, warrants and net loss per share amounts in these financial statements have been restated for all prior periods to reflect the reverse stock split.

b. Stock option plans:

In 1994, 1996, 1999 and 2003 the Company's Board of Directors approved the adoption of Employee Stock Option Plans (the "Plans"), which authorized the grant of options to purchase up to an aggregate of 200,000, 240,000, 1,040,000 and 2,000,000 Ordinary shares, respectively, to officers, directors, consultants and key employees of the Company and its subsidiaries. Options granted under the Plan expire within maximum of ten years from adoption of the plan. The Plans will expire in 2004, 2006, 2009 and 2013, respectively, unless sooner terminated by action of the Board of Directors. Options granted under the Company's Plans vest ratably over three years, one third on each anniversary of the grant.

The exercise price of an option granted to an employee may not be less than 60% of the fair market value of the Ordinary shares on the date of grant of the option. The exercise price of an option granted to a non-employee director or consultant may not be less

than 80% of the fair market value of the Ordinary shares on the date of grant of the option.

Any options that are cancelled or forfeited before expiration, become available for future grants.

At December 31, 2003, 2,110,800 options were available for grant under the Plans described above.

In 2003, the Company granted suppliers/consultants, options to purchase 100,000 Ordinary shares at an exercise price ranging from $0.69 - $2.00. At the grant date, the fair value of the options was determined using the Black and Scholes pricing model assuming a risk free rate of 1%, a volatility factor ranging from 30% to 70%, dividend yield of 0% and a contractual life of two to five years. In relation to the options, the Company recorded $14 as operating expenses.

U.S. dollars in thousands, except share and per share data

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

Transactions related to the above plans (including warrants to directors) during the years ended December 31, 2003, 2002 and 2001 were as follows:

	Year ended December 31,					
	2003		2002		2001	
	Amount of options	Weighted average exercise price	Amount of options	Weighted average exercise price	Amount of options	Wei ave exer pri
Options outstanding at beginning of year	526,000	$ 4.89	1,638,000	$ 5.48	1,742,000	$
Granted	998,000	0.84	-	-	-	
Forfeited or cancelled	(154,800)	6.34	(1,112,000)	5.76	(104,000)	
Options outstanding at end of year	1,369,200	$ 1.77	526,000	$ 4.89	1,638,000	$
Exercisable options at end of year	760,533	$ 2.56	411,600	$ 4.85	949,200	$

No options were granted in 2002 and 2001. The weighted average fair value of options granted in 2003 was immaterial. No compensation expense was recorded for the years ended December 31, 2002 and 2001, respectively.

The following table summarizes information about options outstanding and exercisable at December 31, 2003:

	Options outstanding			Options exercisable	
Range of exercise price	Amount at December 31, 2003	Weighted average remaining contractual life (years)	Weighted average exercise price	Amount at December 31, 2003	Weight averag exerci pric
$ 0.69 - 1.00	843,000	9.52	$ 0.70	334,333	$ 0.
$ 1.34 - 2.00	155,000	9.76	1.57	55,000	2.
$ 3.09 - 4.13	219,600	5.55	3.41	219,600	3.
$ 4.88 - 6.75	151,600	5.23	5.56	151,600	5.
	1,369,200		$ 1.77	760,533	$ 2.

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

c. Warrants:

As of December 31, 2003, warrants to purchase 18,074,032 Ordinary shares were outstanding.

On June 22, 2003, the Company signed a memorandum of agreement, pursuant to which it entered into an agreement with Bank Hapoalim B.M. and Bank Leumi le-Israel B.M. (the "Banks") to restructure a portion of the debt owed to the Banks. The closing took place on September 24, 2003 (the date of the consummation of the transaction). The carrying value of the restructured debt was $3,451. As part of the restructuring, the Company issued 3,781,995 warrants to the Banks, paid cash of $1,100 and the Banks forgave the remaining debt. The warrants issued to the Banks have an exercise price equal to par value of the shares and a term of 2.5 years. The warrants have a lock-up period of 21

months. The Banks have a put option to sell the warrants to the Company's major shareholder for a consideration of $1,251. The put option is exercisable by the Banks only once during the period of 45 days commencing after the end of the period of 18 months from the date of the agreement. In addition, the Banks granted the Company's major shareholder a call option that requires the Banks to sell the warrants to the shareholder at the exercise price of the put option with an additional payment equal up to 25% of the increase in the market share price from the date of the agreement up to a maximum of $0.14 per warrant. The call option may be exercised by the shareholder during the period of 18 months from the date of the agreement and during a period of 45 days commencing after the termination of the put option. The Banks also received 1,100,000 warrants having an exercise price of $2.00 per share, and a term of five years.

The transaction was recorded in accordance with FAS No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings". The warrants issued to the Banks were recorded at fair value ($1,267, net of issuance expenses). The fair value of the warrants was based on the value of an Ordinary share at the consummation date of the transaction (based on a valuation of the warrants prepared by a valuation expert). The difference between the consideration paid to the Banks and the carrying amount of the debt of $1,013, was recognized as a gain on restructuring of debt, net of issuance expenses, presented in financial income (expenses), net, in the statement of operations.

In June 2002, in connection with the private placement described above, the investors were issued warrants to purchase 4,302,041 of the Company's Ordinary shares. Such warrants are valid for five years and are exercisable during the first 36 months after issuance at an exercise price of $ 2 per share, and thereafter, during the following 24 month period, at an exercise price which will be equal to the higher of: (i) $2 per share or (ii) 50% of the average closing price during the ten trading days prior to the exercise date. The proceeds allocated to the warrants, based on the relative fair value of the warrants and shares issued amounted to $41.

U.S. dollars in thousands, except share and per share data

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

In June 2002, in connection with the conversion of a loan that was given to the Company by a shareholder in the amount of $1,350 as described in a. above, the Company issued the shareholder warrants to purchase 8,265,306 Ordinary shares. Such warrants have the same terms as the warrants described above. The proceeds allocated to the warrants, based on the relative fair value of warrants and shares issued amounted to $78. The benefit arising on conversion of the loan amounting to $83, was recorded as interest expense.

The fair value of the warrants described above was estimated using Black-Scholes option-pricing model with the following weighted-average assumptions: risk-free interest rate of 2%, dividend yield of 0%, expected volatility of 24%, and expected life of warrant of five years.

In May 2000, warrants to purchase 388,778 Ordinary shares were issued to investors who participated in the February 2000 private placements, at an exercise price of $2.75 per share, exercisable until June 2003. During 2003, the Company extended the expiration date of the warrants to June 2004. The extension was accounted for in accordance with FIN No. 44, by applying a new measurement date, which resulted in no additional compensation expense. As of December 31, 2003, no shares were issued in respect to the abovementioned warrants.

NOTE 12:- TAXES ON INCOME

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

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

b. Tax benefits under the Law for the Encouragement of Capital Investments, 1959:

The Company has been granted by the Israeli Government under the Law for Encouragement of Capital Investments, 1959 ("the Law") an "Approved Enterprise" status for one investment program in the alternative benefit program. Since the Company is a "foreign investors' company", as defined by the Law, it is entitled to a ten-year period of benefits, for enterprises approved after April 1993. The main tax benefit from the said status is a tax exemption for two years, and eight years of a reduced tax rate (based on the percentage of foreign shareholding in each tax year - 15%-20% tax rate) on income from its approved enterprise, for the remainder of the benefit period commencing with the first year in which the approved enterprise reports taxable income. The commencement of the benefit period is subject to a limitation of the earlier of twelve years from commencement of operations, or fourteen years from receipt of approval. As the Company has not yet reported any taxable income, the benefit period has not yet commenced. Given the aforementioned conditions, the above benefit program will expire in 2004.

U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

In the event of a distribution of cash dividends out of tax-exempt income, the Company will be liable to corporate tax at a rate of 25% in respect of the amount distributed.

Income from sources other than the Approved Enterprise during the benefit period will be subject to tax at the regular corporate tax rate of 36%.

The Company is entitled to charge accelerated depreciation in respect of machinery and equipment used by the Approved Enterprise.

The entitlement to the above mentioned benefits is conditional upon the Company's fulfilling the conditions stipulated by the above mentioned law, regulations published hereunder and the certificates of approval for the specific investments in approved enterprises. In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, with the addition of linkage differences, to the CPI and interest. As at December 31, 2003, management believes that the Company complies with the aforementioned conditions.

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

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

d. As of December 31, 2003, the net operating loss carryforward for tax purposes relating to the Company in Israel amounted to approximately $43,000. Carryforward losses in Israel may be carried forward indefinitely and may be offset against future taxable income.

As of December 31, 2003, carryforward losses relating to non-Israeli companies (U.S. and China), amounted to approximately $9,750.

As the Company believes that the tax assets in respect of these carryforward losses amounting to approximately $19,000 is not more likely than not to be realized, the Company has recorded a valuation allowance in respect of the entire amount of the deferred tax asset relating to the carryforward losses.

e. Income (loss) before income taxes:

	Year ended December 31,		
	2003	2002	2001
Domestic	$ 867	$ (2,175)	$ (2,837)
Foreign	(109)	(308)	(532)
	$ 758	$ (2,483)	$ (3,369)

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

U.S. dollars in thousands

NOTE 12:- TAXES ON INCOME (Cont.)

g. Amendment 132 to Israel's Income Tax Ordinance:

In July 2002, Amendment No. 132 to Israel's Income Tax Ordinance ("the Amendment") was approved by the Israeli parliament and is effective as of January 1, 2003. The principal objectives of the Amendment were to broaden the categories of taxable income and to reduce the tax rates imposed on employment income.

There are no material implications of the Amendment applicable to the Company, except certain modifications in the qualified taxation tracks of employee stock options. As a result, in 2003, the Company entered into the 2003 share option plan.

NOTE 13:- SELECTED STATEMENTS OF OPERATIONS DATA

a. Financial income (expenses), net:

	Year ended December 31,		
	2003	2002	2001
Income:			
Gain on restructuring of debt, net (see Note 11c)	$ 1,013	$ -	$
Foreign currency exchange differences	-	169	
Interest on cash equivalents	9	4	
	1,022	173	
Expenses:			
Foreign currency exchange differences	22	-	
Interest on short-term loans and other credit balances	230	253	
Bank commissions	59	96	
Interest to related parties	-	89	
Loss on extinguishment of debt	-	83	
Others	3	16	
	314	537	

	$ 708	$ (364)	$ (

b. Other expenses, net:

Impairment of loan to Jetborne (see Note 5)	$ -	$ (290)	$
Loss on sale of subsidiary	-	-	
Others, net	(2)	-	
	$ (2)	$ (290)	$

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 14:- RELATED PARTY TRANSACTIONS

There are no related party balances as of December 31, 2003 and 2002. Related party transactions reflected in the statement of operations for the years ended December 31, 2003, 2002 and 2001 are as follows:

	Year ended December 31,		
	2003	2002	2001
Related party (*):			
Revenues	$ -	$ 394	$ -
Purchases	$ -	$ -	$ 43
Shareholder:			
Interest expense	$ -	$ 89	$ 61
Loss on extinguishment of loan	$ -	$ 83	$ -

(*) A company controlled by Company shareholder.

See also Note 11c.

NOTE 15:- MAJOR CUSTOMERS AND GEOGRAPHIC INFORMATION

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

debriefing systems.

b. Revenues by geographic areas:

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

	Year ended December 31,		
	2003	2002	2001
North America	$ 5,115	$ 6,671	$ 3,931
Europe	3,436	1,599	1,826
Israel	3,224	1,442	1,963
Others	540	687	622
Total	$ 12,315	$ 10,399	$ 8,342

U.S. dollars in thousands

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

c. Major customers:

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

	Year ended December 31,		
	2003	2002	2001
	%		
Customer A	11	*)	12
Customer B	12	*)	*)
Customer C	22	34	*)
Customer D	14	19	16
Customer E	-	*)	17
Customer F	19	*)	-

*) Less than 10%.

d. Long lived assets by geographic areas:

	December 31,		
	2003	2002	2001

Israel	$5,179	$6,977	$ 8,691
China	1,536	1,761	2,444
	$6,715	$8,738	$11,135

RADA ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 16:- NET EARNINGS (LOSS) PER SHARE

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

	Year ended December 31,		
	2003	2002	2001
		%	
Numerator:			
Net income (loss)	$ 758	$ (2,483)	$ (3,
Denominator:			
Weighted average number of shares of Ordinary stock outstanding during the year used to compute basic net earnings (loss) per share (in thousands)	18,511	16,555	13,
Incremental shares attributable to exercise of outstanding options (assuming proceeds would be used to purchase Treasury stock) (in thousands)	1,193	-	
Weighted average number of shares of Ordinary stock outstanding during the year used to compute diluted net earnings (loss) per share (in thousands)	19,704	16,555	13,
Basic net earnings (loss) per share	$ 0.04	$ (0.15)	$ (0
Diluted net earnings (loss) per share	$ 0.04	$ (0.15)	$ (0

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S I G N A T U R E S

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

RADA ELECTRONIC INDUSTRIES LTD.

By: /s/ Herzle Bodinger
Name: Herzle Bodinger
Title: President

Dated: April 15, 2004