

Ituran Location & Control Ltd.  
Form 20-F  
June 30, 2008

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**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 20-F**

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

*For the fiscal year ended December 31, 2007*

**Commission file no. 001-32618**

**ITURAN LOCATION AND CONTROL LTD.**

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

**Israel**

(Jurisdiction of incorporation or organization)

**3 Hashikma Street, Azour, Israel**

(Address of principal executive offices)

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

| Title of each class  | Name of each exchange on which registered |
|--|---|
| <b>Ordinary Shares, par value NIS 0.33<math>\frac{1}{3}</math> per share</b> | <b>Nasdaq National Market</b>             |

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

**None**

(Title of Class)

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

**None**

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

**23,475,431 Ordinary Shares**

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

Yes  No

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

Yes  No

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

Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated filer

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

Item 17  Item 18

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

Yes  No

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II

**PART III**

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

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

**FORWARD LOOKING STATEMENTS**

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

III

**PART I**

|  |  |
|--|--|
| <b>ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS</b> |  |
| Not applicable.  |  |

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION****A. SELECTED FINANCIAL DATA**

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

Our selected consolidated statements of operations data for the years ended December 31, 2005, 2006 and 2007 and our selected consolidated balance sheet data as of December 31, 2006 and 2007 have been derived from our consolidated financial statements, included elsewhere in this report. The selected consolidated statements of operations data for each of the years ended December 31, 2003 and 2004 and the selected consolidated balance sheet data as of December 31, 2003, 2004 and 2005 are derived from other audited financial statements not included in this report.

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

|  | Year Ended December 31,                       |                |               |               |               |
|--|---|----------------|---------------|---------------|---------------|
|  | 2007  | 2006           | 2005          | 2004          | 2003          |
|  | <i>In USD</i>                                 |                |               |               |               |
|  | <i>In thousands, except per share amounts</i> |                |               |               |               |
| <b>Revenues:</b>                         |   |                |               |               |               |
| Location based services                  | 64,634  | 54,048         | 44,128        | 36,549        | 32,088        |
| Wireless communications products         | 60,204  | 50,004         | 43,806        | 33,461        | 23,527        |
| Other                                    |   |                | 2,192         | 7,916         | 8,456         |
| <b>Total Revenues</b>                    | <b>124,838</b>                                | <b>104,052</b> | <b>90,126</b> | <b>77,926</b> | <b>64,071</b> |
| <b>Cost of Revenues:</b>                 |   |                |               |               |               |
| Location based services                  | 23,630  | 18,419         | 14,987        | 12,944        | 12,258        |
| Wireless communication products          | 44,009  | 35,434         | 30,956        | 23,224        | 19,071        |
| Other                                    |   |                | 1,643         | 5,720         | 6,119         |
| <b>Total cost of revenues</b>            | <b>67,639</b>                                 | <b>53,853</b>  | <b>47,586</b> | <b>41,888</b> | <b>37,448</b> |
| <b>Gross profits</b>                     | <b>57,199</b>                                 | <b>50,199</b>  | <b>42,540</b> | <b>36,038</b> | <b>26,623</b> |
| <b>Operating Expenses:</b>               |   |                |               |               |               |
| Research and development expenses        | 2,991   | 2,682          | 2,799         | 2,020         | 1,692         |
| Selling and marketing expenses           | 8,218   | 5,123          | 4,876         | 4,074         | 2,888         |
| General and administrative expenses      | 22,629  | 17,659         | 14,959        | 11,693        | 11,443        |
| Other expenses (income), net             | (49,138)                                      | 3              | (16)          | (12)          | 314           |
| <b>Total operating expenses (income)</b> | <b>(15,300)</b>                               | <b>25,467</b>  | <b>22,618</b> | <b>17,775</b> | <b>16,337</b> |

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|  |          |         |                      |         |         |
|--|----------|---------|----------------------|---------|---------|
| Operating Income                                     | 72,499   | 24,732  | 19,922               | 18,263  | 10,286  |
| Financing income (expenses), net                     | 1,227    | 1,886   | 906                  | (2,059) | (616)   |
| Other non-operating expenses, net                    |          |         |                      |         |         |
| Income (loss) before taxes on income                 | 73,726   | 26,618  | 20,828               | 16,204  | 9,670   |
| Taxes on (income) loss                               | (20,953) | (6,581) | (5,295)              | (4,423) | (3,417) |
| Income (loss) after tax on income                    | 52,773   | 20,037  | 15,533               | 11,781  | 6,253   |
| Share in losses of affiliated companies, net         | (516)    | (213)   | (355)                | (324)   | (235)   |
| Minority interest in income (losses) of subsidiaries | (783)    | (565)   | (803) <sup>(1)</sup> | (238)   | (173)   |
| Net income (loss)                                    | 51,474   | 19,259  | 14,375               | 11,219  | 5,845   |

**Earning per share<sup>(2)</sup>**

|         |         |         |         |         |         |
|---------|---------|---------|---------|---------|---------|
| Basic   | \$ 2.21 | \$ 0.83 | \$ 0.73 | \$ 0.60 | \$ 0.32 |
| Diluted | \$ 2.20 | \$ 0.82 | \$ 0.71 | \$ 0.58 | \$ 0.31 |

**Weighted average number of shares outstanding<sup>(2)</sup>**

|         |        |        |        |        |        |
|---------|--------|--------|--------|--------|--------|
| Basic   | 23,315 | 23,194 | 19,736 | 18,585 | 18,273 |
| Diluted | 23,422 | 23,457 | 20,254 | 19,192 | 19,086 |

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

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

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**Consolidated Balance Sheets Data**

|  | As of December 31,                            |         |         |         |          |
|--|---|---------|---------|---------|----------|
|  | 2007  | 2006    | 2005    | 2004    | 2003     |
|  | <i>In USD</i>                                 |         |         |         |          |
|  | <i>In thousands, except per share amounts</i> |         |         |         |          |
| Cash & Cash Equivalent (and investment in marketable securities) | 38,227  | 59,846  | 58,429  | 4,604   | 3,918    |
| Working Capital  | 110,432                                       | 73,434  | 60,995  | 2,508   | (3,624)  |
| Total Assets   | 216,559                                       | 144,839 | 116,484 | 59,023  | 54,731   |
| Total Liabilities  | 66,968  | 47,968  | 40,722  | 44,022  | 50,942   |
| Retained Earnings (accumulated deficit)                          | 66,239  | 19,604  | 4,048   | (7,630) | (17,522) |
| Shareholders Equity  | 149,591                                       | 96,871  | 75,762  | 15,001  | 3,789    |

**Other Data:**

|  | As of December 31, |      |      |      |      |
|--|--------------------|------|------|------|------|
|  | 2007               | 2006 | 2005 | 2004 | 2003 |
|  | (unaudited)        |      |      |      |      |

|   |         |         |         |         |         |
|---|---------|---------|---------|---------|---------|
| Subscribers of our location-based services <sup>(1)</sup> | 444,000 | 396,000 | 339,000 | 262,000 | 210,000 |
| Average monthly churn rate                                | 2.1%    | 1.8%    | 1.5%    | 1.5%    | 1.4%    |

(1) Number of subscribers is approximate

#### **B. CAPITALIZATION AND INDEBTEDNESS**

Not applicable.

#### **C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not applicable.

#### **D. RISK FACTORS**

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

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### **RISKS RELATED TO OUR BUSINESS**

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

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

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

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

Therefore, we rely on insurance companies continued practice of:

- § accepting vehicle location and recovery technology as a preferred security product;
- § requiring or providing a premium discount for using location and recovery services and products;
- § mandating or encouraging use of our SVR services and AVL products, or similar services and products, for vehicles with the same or similar threshold values and for the same or similar required duration of use; and

§ with respect to insurance companies in Brazil and Argentina, deciding to purchase or lease SVR services and AVL products from us directly.

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In 2008, we entered into an agreement with Telematics, pursuant to which Ituran and Telematics designated parts of the world as their exclusive territories for selling their AVL products and SVR services using any RF location technology compatible to the Teletrac System.

This agreement restricts our ability to expand our business and operations and sell our products and services in certain markets, which could adversely affect our growth potential.

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

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

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

We outsource the manufacturing of most of our wireless communications products to third parties. Furthermore, we use one manufacturer for production of a significant portion of our wireless communications products and we do not maintain significant levels of inventories to support us in the event of an unexpected interruption in its manufacturing process. If our principal manufacturer or any of our other

manufacturers is unable to or fails to manufacture our products in a timely manner, we may not be able to secure alternative manufacturing facilities without experiencing an interruption in the supply of our products or an increase in production costs. Any such interruption or increase in production costs could affect our ability to provide our wireless communications products in a timely and cost-effective manner, adversely impacting our revenues and profit margins.

**We rely on Telematics Wireless Ltd. (previously owned by us) to supply us with various products and services as single supplier of such products and services. Termination of our agreement with Telematics in respect of such products and services could adversely affect our revenues and operations.**

Following the sale of our subsidiary, Telematics Wireless Ltd. in 2007 to a third party and the execution of a 10-year supply agreement with Telematics as a result of such sale, we rely on Telematics as single supplier of products and services. Termination of our relations with Telematics would adversely affect our operations and revenues.

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

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

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

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

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

We anticipate future growth to be attributable to our business activities in new markets, particularly in developing countries, where we may encounter additional risks and challenges, such as longer payment cycles, potentially adverse tax consequences, potential difficulties in collecting receivables and potential difficulties in enforcing agreements or other rights in foreign legal systems. The challenges and risks of entering a new market may delay or preclude our ability to generate anticipated revenues and may impede our overall growth strategy.

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

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

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

Our AVL products are primarily installed in medium- and high-end cars and commercial vehicles. Therefore, our ability to increase demand for our SVR services and revenues from sales of our AVL products is limited by the number of potential vehicles in which our products can be installed in each relevant market. We currently estimate that our AVL products are installed in a significant portion of the medium- and high-end cars and commercial vehicles in Israel. We anticipate that revenues from sales of our SVR services and AVL products in Israel will not

increase significantly due to the already high penetration of SVR services and AVL products in Israel and moderate overall growth of the addressable market in Israel, which could adversely affect our prospects for growth in such markets.

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

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

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

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

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

The provision of our SVR services depends upon adequate network coverage for accurate tracking information. In Israel, we have installed 96 base sites that provide complete communications coverage in Israel. Similarly, we have established complete communications coverage in Sao Paulo and Rio, Brazil, Buenos Aires, Argentina and Miami, Florida. The installation and operation of most of our base sites

require building permits from local or regional zoning authorities as well as a number of additional permits from governmental and regulatory authorities.

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

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

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

### **RISKS RELATED TO OUR OPERATIONS IN ISRAEL**

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

Our headquarters and sole research and development facilities are located in Israel and our key employees, officers and directors are residents of Israel. Accordingly, security, political and economic conditions in Israel directly affect our business. Over the past several decades, a number of armed conflicts have taken place between Israel and its Arab neighbors. Since 2000, hostilities have increased in intensity and regional political uncertainty has also increased. The establishment in 2006 of a government in the Palestinian Authority by representatives of the Hamas militant group, and the virtual take-over of the Gaza Strip by Hamas in June 2007 has created unrest and uncertainty in the region. Further escalation has occurred during 2008. Continued or increased hostilities, future armed conflicts, political developments in other states in the region or continued or increased terrorism could make it more difficult for us to conduct our operations in Israel, which could increase our costs and adversely affect our financial results.

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

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

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

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

We are incorporated and headquartered in Israel. As a result, our executive officers and directors are non-residents of the United States and a substantial portion of our assets and the assets of these persons are located outside of the United States. Therefore, service of process upon

any of these officers or directors may be difficult to effect in the United States. Furthermore, it may be difficult to enforce a judgment issued against us in the United States against us or any of such persons in both United States courts and other courts abroad.

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

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

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

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

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

**RISKS RELATED TO THE MARKET AND OUR ORDINARY SHARES**

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

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

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

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

- § the gain or loss of significant orders or customers;
- § recruitment or departure of key personnel;
- § the announcement of new products or service enhancements by us or our competitors;
- § quarterly variations in our or our competitors' results of operations;
- § announcements related to litigation;

- § changes in earnings estimates, investors' perceptions, recommendations by securities analysts or our failure to achieve analysts' earnings estimates;
- § developments in our industry; and
- § general market conditions and other factors unrelated to our operating performance or the operating performance of our competitors.

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

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

Our directors and officers, in the aggregate, currently beneficially own or control approximately 30.45% of our outstanding ordinary shares. Other than applicable regulatory requirements under applicable law, these shareholders are not prohibited from selling a controlling interest in our company to a third party. These shareholders, acting together, could exercise significant influence over our operations and business strategy and may use their voting power to influence all matters requiring approval by our shareholders, including the ability to elect or remove directors, to approve or reject mergers or other business combination transactions, the decision to raise additional capital and the amendment of our articles of association that govern the rights attached to our ordinary shares. In addition, this concentration of ownership may delay, prevent or deter a change in control, or deprive our shareholders of a possible premium for ordinary shares as part of a sale of our company.

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

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

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

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

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

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

**ITEM 4. INFORMATION ON THE COMPANY**

**A. HISTORY AND DEVELOPMENT OF THE COMPANY**

**Our History**

We are mainly engaged in the area of location-based services, consisting of stolen vehicle recovery and tracking services. We also provide wireless communication products used in connection with our location-based services and various other applications. We currently provide our services and sell our products in Israel, Brazil, Argentina and the United States. In 2006 we acquired 51% of the issued share capital of ERM Electronic Systems Limited ( ERM ) for \$2.8 Million. ERM develops, manufactures, and markets innovative vehicle security, tracking, and management GSM based communication solutions for the international market. The ERM acquisition adds a number of cutting edge security and tracking solutions to our existing product portfolio. In 2007 we acquired 100% of the share capital of Mapa, a leading and largest provider of geographical information (GIS) in Israel and owner of geographic information database for navigation in Israel, GISrael (the Mapa Group ) from its shareholders for approx. US\$9.9 million. In addition, we invested an additional sum of approx. US\$3.1 million in the Mapa Group, which was used to repay Mapa Group's loans to its shareholders. .

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

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

In December 31, 2007, we completed the sale of our subsidiary, Telematics Wireless Ltd., to ST (Infocomm). Pursuant to the sale transaction, we sold our entire shareholdings, constituting 93.93% of Telematics Wireless to the purchaser, for an enterprise value of US\$90 million (following repurchase of our shares in Telematics for the aggregate sum of US\$5,000,000). The purchase price is subject to adjustments based on performance parameters of Telematics in the years 2007 and 2008 and subject to adjustment for failure to meet certain financial covenants.

In January 2008, we entered into a 10 year Frame Product and Service Purchase Agreement with Telematics, pursuant to which the Company and Telematics shall purchase from each other certain products and services as detailed in the agreement for price and other conditions as detailed in the agreement. In addition, each of Ituran and Telematics undertook toward one another not to compete in each other's exclusive markets in the area of Teletrac system and technology or similar RF terrestrial location systems and technology. The agreement is for a term of 10 years, following which it shall be renewed automatically for additional consecutive 12 months period, unless non-renewal notice is provided by one of the parties to the other.

Concurrently with the sale of Telematics, the Company and Telematics entered into a revenue sharing agreement, pursuant to which Ituran shall be entitled to a share of the sales revenues of Telematics in the Republic of Korea and in China from sale of end products and base stations to customers in such territories as well as from royalties received from customers of Telematics in such territories relating to the AVL applications. The revenue sharing scheme shall continue for a term of five (5) years from January 2008 and shall be paid on a quarterly basis.

In March 2007, we entered into an agreement whereby we acquired approximately 4% of the issued and outstanding share capital in Korean Location Information and Communications for 1.5M US Dollars. We were also granted with option right for additional shares at the total purchase price of 1M US Dollars within two years following such acquisition.



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We had capital expenditure of \$9.6 million in 2007, \$12.1 million in 2006 and \$3.5 million in 2005. We have financed our capital expenditure with cash generated from our operations.

Our capital expenditures in 2007, 2006 and 2005 consisted primarily from acquisition of operational equipment for \$5.7 million, \$3.1 million and \$2.4 million, respectively.

### **B. BUSINESS OVERVIEW OVERVIEW**

We believe we are a leading provider of location-based services, consisting predominantly of stolen vehicle recovery and tracking services. We also provide wireless communications products used in connection with our location-based services. We currently provide our services and sell our products in Israel, Brazil, Argentina and the United States. We utilize technologies that enable precise and secure high-speed data transmission and analysis. Some of the technology underlying our products was originally developed for the Israeli Defense Forces in order to locate downed pilots.

We generate our revenues from subscription fees paid for our location-based services and from the sale of our wireless communications products. Since 1998, we have achieved sequential growth in quarterly revenues from subscription fees.

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

#### **Location-Based Services**

In 2007, 52% of our revenues were attributable to our location-based services. As of December 31, 2007, we provided our services in Israel, Brazil, Argentina and the United States to approximately 194,000, 135,000, 97,000 and 18,000 subscribers, respectively.

##### *Stolen vehicle recovery services*

Our stolen vehicle recovery and tracking services, which we refer to as SVR services, enable us to locate, track and recover stolen vehicles for our subscribers. Our customers include both individual vehicle owners who subscribe to our services directly and insurance companies that either require their customers to install a security system or offer their customers financial incentives to subscribe to SVR services such as ours. In certain countries, insurance companies directly subscribe to our SVR services and purchase automatic vehicle location products supporting these SVR services from us on behalf of their customers. In 2007, we recovered approximately 5,000 vehicles with a total value of approximately \$130 million. We have been experiencing strong penetration in Brazil and Argentina where we have grown our subscriber base from approximately 25,000 and 5,000 in 2002 to approximately 135,000 and 97,000 in 2007, representing an increase of 440% and 1840% respectively over such 5 year period. Over the last five years, our monthly subscriber churn rates have averaged under 2% per month, our stolen vehicle recovery rates have averaged approximately 85%, based on the total number of our subscribers' vehicles stolen and recovered in cases of either a real time call is made by our subscriber advising us of the theft or a call is received from our control center in the markets we serve, and our average vehicle recovery time, from the time an unauthorized entry is confirmed or reported to the time the vehicle is recovered, has, based on our records, averaged approximately 20 minutes.

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##### *Fleet management services*

Our fleet management services enable corporate customers to track and manage their vehicles in real time. Our services improve appointment scheduling, route management and fleet usage tracking, thereby increasing efficiency and reducing operating costs for our customers. We market and sell our services to a broad range of vehicle fleet operators in different geographic locations and industries. As of December 31, 2007, we provided our services to approximately 48,000 end-users through 3,800 corporate customers in Israel, Brazil, Argentina and the United States.

##### *Value-added services*

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Our Personal Advanced Locator, which we refer to as PAL, services allow customers to protect valuable merchandise and equipment, as well as track individuals. In addition, through a call center we provide 24-hour on-demand navigation guidance, information and assistance to our customers. We currently provide our PAL services in Israel only and, as of December 31, 2007, we had approximately 5,400 subscribers to this service. In addition, through a call center, we provide 24-hour on-demand navigation guidance, information and assistance to our customers. Such services include the provision of traffic reports, help with directions and information on the location gas stations, car repair shops, post offices, hospitals and other facilities. We provide our concierge services to our subscribers in Israel, Argentina and Brazil. As of December 31, 2007, we had approximately 18,000 subscribers to our concierge service in Israel.

### Wireless Communications Products

In 2007, 48% of our revenues were attributable to the sale of our wireless communications products. Our wireless communications products employ short- and medium-range communication between two-way wireless modems and are used for various applications, including automatic vehicle location, which we refer to as AVL. In 2007 we sold our subsidiary, Telematics and thus two applications of our wireless communications products, namely, automatic meter reading (AMR) and radio frequency identification (RFID) were discontinued upon the closing of such sale.

Our AVL products enable the location and tracking of vehicles, as well as assets and persons, and are used by us primarily to provide SVR and fleet management services to our customers. Each subscriber to our SVR services has our AVL end-unit installed in his or her vehicle. Subscribers to services for locating persons will either use our PAL product. As part of our expansion into new markets, we acquired control of E.R.M. Electronic Systems Limited (ERM), a developer, manufacturer, and marketer of innovative vehicle security, tracking, and management GSM based communication solutions for the international market.

### Industry Overview and Trends

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

#### (a) Location-based services

##### *Stolen vehicle recovery*

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

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

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

recovery of the vehicle in real time.

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

*Fleet management*

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

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

**(b) Wireless communications products**

*Automatic vehicle location*

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

Typical AVL applications include:

| <b>Security</b>                     | <b>Transportation</b>             | <b>Emergency and health care</b> | <b>Telecommunication services</b> | <b>Government</b>           |
|-------------------------------------|-----------------------------------|----------------------------------|-----------------------------------|-----------------------------|
| Vehicle tracking                    | Fleet management                  | Patient tracking                 | Maintenance vehicle tracking      | Government vehicle tracking |
| Personal tracking<br>Asset tracking | Parcel tracking<br>Public transit | Ambulance tracking               |                                   |                             |

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

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

### Products

#### *Location-based services*

##### *Stolen vehicle recovery*

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

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##### *Fleet management*

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

##### *Value-added services*

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

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

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

##### *Wireless communications products*

Our wireless communications products are used for various applications in the AVL markets.

##### *Automatic vehicle location*

Our AVL products enable the location and tracking of vehicles, as well as assets or persons, and are primarily used by us in providing our SVR and fleet management services. Each subscriber to our SVR services has one of our end-units installed in his or her vehicle. Subscribers to services for locating persons will either use our PAL product or will have our end-unit installed in a watch or other accessory, an additional option currently under development. Our key wireless communications products for AVL applications include:

- § **TULIP:** a transmitter installed in vehicles that sends a signal to the base site, enabling the location of a vehicle;
- § **MAPLE:** an alarm system that identifies an intruder and activates the transmitter to send a signal to the base site;
- § **PAL:** a portable transmitter located on an asset or on an individual that sends a signal to the base site, enabling the location of the asset or individual;

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- § **Base Site:** a radio receiver, which includes a processor and a data computation unit to collect and send data to and from transponders and send that data to control centers as part of the terrestrial infrastructure of the location system; and
- § **Control Center:** a center consisting of software used to collect data from various base sites, conduct location calculations and transmit location data to various customers and law enforcement agencies.
- § **GPS/GPRS-based products:** navigation and tracking devices installed in vehicles

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

| Country       | Services offered or intended to be offered      | Products sold or intended to be sold |
|---------------|---|--------------------------------------|
| Israel        | SVR<br>Fleet management<br>Value-added services | AVL                                  |
| Brazil        | SVR<br>Fleet management<br>Value-added services | AVL                                  |
| Argentina     | SVR<br>Fleet management<br>Value-added services | AVL                                  |
| United States | SVR<br>Fleet management                         | AVL                                  |

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

- § **Israel:** We commenced operations in Israel in 1995 and we had approximately 194,000 subscribers as of December 31, 2007. We maintain 96 base stations in Israel, which provide complete coverage within the country. Our control center operates 24 hours a day, 365 days a year and is located in Azour.
- § **Brazil:** We commenced operations in Brazil in 2000 and we had approximately 135,000 subscribers as of December 31, 2007. We currently provide RF based products and services only in the metropolitan areas of Sao Paulo and Campinas and Rio de Jenero, however we operate throughout Brazil in providing GPS/GPRS based products and services.
- § **Argentina:** We commenced operations in Argentina in 2002 and we had approximately 97,000 subscribers as of December 31, 2007. We currently operate only in the metropolitan area of Buenos Aires.
- § **United States:** We commenced operations in the United States in 2000 and until 2004 we operated only in Florida. We currently provide GPS/GPRS products and services throughout the United States and provide RF based products and services only in Florida. As of December 31, 2007, we had 18,000 subscribers for our location-based services in the United States.

### Customers, Marketing and Sales

We market and sell our products and services to a broad range of customers that vary in size, geographic location and industry. In 2005, no single customer or group of related customers comprised more than 10% of our total revenues. In 2006, other than Arad Technologies, which represented 12.7% of our revenues in 2006, no single customer or group of related customers comprised more than 10% of our total revenues. In 2007, other than Arad Technologies, which represented 10.8% of our revenues in 2007, no single customer or group of related customers comprised more than 10% of our total revenues.

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### (A) Location-based services

*Stolen vehicle recovery*

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

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

In Israel, Brazil and Argentina, we focus our marketing efforts primarily on insurance companies. In the United States, we believe that insurance companies do not constitute a material influence in the marketing of SVR services or AVL products. Most of our sales in the United States are made through car dealers for new or used cars. Our customers in the SVR market include insurance companies as well as individual vehicle owners. As of December 31, 2007, we had approximately 444,000 subscribers.

*Fleet management*

Vehicle fleet management systems are marketed through a vehicle fleets department, which is a part of our marketing department. We conduct in-depth research to identify companies that will gain efficiency and cost savings through the implementation of our products and services, and conduct targeted marketing campaigns to these companies. In addition, we participate in professional conventions and advertise in professional publications and journals designed for our target customers. Currently, our fleet management services are also marketed by the sales force of one of the largest cellular service providers in the United States. Our customers in the fleet management market include small-, mid- and large-size enterprises. As of December 31, 2007, we provided our services to approximately 48,000 end users through 3,800 corporate customers in Israel, Brazil, Argentina and the United States.

*Value-added services*

Our concierge services are provided to existing SVR customers. As of December 31, 2007, we had approximately 18,000 subscribers to our concierge service in Israel and approximately 5,400 of our PAL devices were installed in valuable merchandise and equipment, or carried by individuals.

**(B) Wireless communications products**

Our AVL end-units are primarily used by us in providing our location-based services in Israel, Brazil, Argentina and the United States.

Our selling and marketing objective is to achieve broad market penetration through targeted marketing and sales activities. As of December 31, 2007, our selling and marketing team consisted of 75 employees.

**Competition**

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

**(A) Location-based services**

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

*Stolen vehicle recovery*

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

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

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

### *Fleet Management*

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

### **(B) Wireless communications products**

#### *Automatic vehicle location*

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

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

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

## Manufacturing Operations and Suppliers

Most of our wireless communications products are manufactured and assembled by a limited number of unaffiliated manufacturers in Israel. We engage with our manufacturers either on a full turn-key basis, where we supply detailed production files and materials list and receive a final product that we sell directly to our clients, or on a partial turn-key basis in which we purchase the raw materials and deliver them to our manufacturers that do the manufacturing, assembly and quality assurance checks. Other than our dependency on Telematics, as described in Item 3, *Risk Factors* above, we do not depend on a single manufacturer for the production of our products. Our main manufacturers are Telit Communications SPA and Telematics (our recently sold subsidiary). For further details of our agreement with Telematics concerning the supply of products and services see Item 4.A *History and Development of our Company* under the caption *Our History* above.

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

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

## Proprietary Rights

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

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

Our stolen vehicle recovery system is based on three main components: (i) an AVL end-unit that is installed in the vehicle, the components of which were originally developed by Tadiran and were acquired and improved by us, (ii) a network of base stations that relay information between the vehicle location units and the control center, certain components of which were developed by Teletrac and are currently licensed to us by Teletrac and (iii) a 24-hour manned control center consisting of software used to manage communications and the exchange of information among the hardware components of the AVL system, certain components of which were developed by Teletrac and licensed to us under exclusive and non-exclusive licenses. For details concerning the non-exclusive license granted by Telematics to us in respect of the Teletrac system and technology and license granted by us to Telematics in respect of our technology incorporated in the Teletrac system, please refer to Item 4.A. *History and Development of our Company* under the caption *Our History* above.

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

## Regulatory Environment

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

The frequency license and general commerce licenses we require are granted by the applicable national agency regulating communications in the markets in which we operate, specifically, the Ministry of Communication, in Israel, Anatel - Agencia Nacional de Telecomunicacoes, in Brazil, the Comision Nacional de Comunicaciones, in Argentina, and the Federal Communications Commission, in the United States. The product specific licenses we require are granted in Israel by the Ministry of Communication, in Brazil by IBRACE (the Instituto Brasileiro de



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Certificatao de Productos para Telecomunicatoes), in Argentina by the National Technological Institute of Argentina and in the United States by the Federal Communications Commission.

Our frequency licenses in all of the locations where we operate are secondary or joint, which means that the government may grant another person or persons, typically a cellular operator, a primary license to the same frequencies and, to the extent our operations interfere with the operations of the other person, we would have to modify our operations to accommodate the joint use of the frequencies. As a condition to the renewal of the license, we were required by the Ministry of Communication to amend our articles of association in order to include a provision according to which certain officers and directors are required to be Israeli citizens and residents and be pre-approved by the Israeli security authorities. Accordingly, we have amended in January 2008 our articles of association to reflect the necessary requirements. The new license was issued to us in July 2007 and is valid until July 2012. All of these licenses are also subject to revocation, alteration or limitation by the respective authority granting them. While any events that would cause us to change frequencies or to modify our operations could have a material adverse effect on us, we do not believe that this is a likely event in any of the locations where we provide our SVR services.

Our frequency license in Israel expires in 2012. Our frequency licenses in Brazil expire in 2009 and, in Miami and Orlando, our licenses expire between 2009 and 2013. We have options to extend all of our frequency licenses for periods ranging from three- to 10-year periods.

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In Israel and Brazil, like our competitors and most cellular operators, we are not in compliance with all relevant laws and regulations in connection with the erection of transmission antennas (our base sites). As of 2007, most of our base sites in Israel and Brazil are operating without local building permits. Currently, there is heightened awareness of this issue in Israel, particularly in connection with base sites of cellular providers, and possible sanctions could include fines and even the closure or demolition of these base sites. However, we do not believe this is likely. Obtaining such required permits may involve additional fees as well as payments to the Land Administration Authority.

In Israel the required permits and approvals include:

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

We are currently in the process of obtaining the relevant permits required for the construction of our base sites in Israel, however, to date, we have been issued 7 of these permits. With respect to the general permit from Israel's Land Administration, in 2005, we entered into an agreement with the Israel's Land Administration, effective until December 31, 2008, pursuant to which the general permit has been issued to us against an annual consideration based on the date of approval of our base sites. The process for obtaining these approvals in Israel is generally a time-consuming, highly bureaucratic and lengthy process. As a result, it is common practice among providers of wireless telecommunications services in Israel to continue operations while engaged in the approval process.

In Brazil, very few providers of wireless telecommunications services obtain the required permits due to the nature of the approval process. We have applied for the necessary permits, but do not expect to receive such permits in the near future. In Brazil, we try to minimize our risk by locating most of our equipment in sub-leased sites which are already used by other telecommunication service providers, such as cellular operators.

In Brazil the required permits includes:

- § Anatel (National Agency for Telecommunication)
- § IBAMA (Environment national agency)
- § Municipal permits
- § Fire department.

## § COMAR (Aviation authorities)

ANATEL permits are required only for sites where we have transmission equipment and we have obtained all the permits required with this agency. IBAMA permits need to be obtained only for ground sites which are located in preservation areas. We have few sites of this kind, most of them are collocated sites where we pay for the right of use and permits are undertaken by the landowner. Fire Department permits are required only for equipment rooms and we have not applied for any as of this time. COMAR permits are needed only for a very few of our sites, most of which are collocated.

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

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**C. ORGANIZATIONAL STRUCTURE**

We were initially incorporated as a subsidiary of Tadiran, an Israeli-based designer and manufacturer of telecommunications equipment, software and defense electronic systems, whose original business purpose was to adapt military-grade technologies for the civilian market. In July 1995, Moked Ituran Ltd. purchased our company and the assets used in connection with its operations from Tadiran and Tadiran Public Offerings Ltd. The AVL infrastructure and AVL end-units for the operation of our SVR services were originally developed by an independent division of Tadiran Communications and Systems Group. These operations were later transferred to a Tadiran subsidiary, Tadiran Telematics Ltd. In November 1999, we purchased Tadiran Telematics from Tadiran and in 2002, we changed its name to Telematics Wireless. In December 2007 we sold our subsidiary Telematics for further information please refer to Item 4.A. History and Development of the Company under the caption *Our History* above.

**List of Significant Subsidiaries**

| Name of Subsidiary                     | Country of Incorporation | Proportion of Ownership Interest |
|--|--------------------------|----------------------------------|
| Telematics Wireless Ltd.               | Israel                   | 93.93%#                          |
| Ituran Cellular Communication Ltd.     | Israel                   | 100%*                            |
| Ituran USA Holdings Inc.               | USA                      | 100%**                           |
| Ituran NY Corporation                  | USA                      | 100%***                          |
| Ituran Beheer B.V.                     | The Netherlands          | 100%                             |
| Ituran USA Inc.                        | USA                      | 90%****                          |
| Ituran License Corp.                   | USA                      | 100%*****                        |
| Ituran de Argentina S.A.               | Argentina                | 91%*****                         |
| Ituran Sistemas de Monitoramento Ltda. | Brazil                   | 97.5%*****                       |
| Teleran Holding Ltda.                  | Brazil                   | 99.99%*****                      |
| E.R.M. Electronic Systems Limited      | Israel                   | 51%                              |
| Mapa Internet Ltd.                     | Israel                   | 100%                             |
| Mapa Mapping & Publishing Ltd.         | Israel                   | 100%                             |

# On December 31, 2007, we sold our entire holdings in Telematics, which constituted at that time 93.93% of the issued share capital (following repurchase of shares by Telematics and as a result of issuance of shares of Telematics to senior management of Telematics) for further information please refer to Item 4.A. History and Development of the Company under the caption *Our History* above.

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

\*\*previously known as Ituran USA Inc.

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

\*\*\*\* Previously known as Ituran Florida Corporation. 90% of the shares are held by Ituran U.S.A. Holding Inc. which is our wholly owned

subsidiary.

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

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

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

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

#### **D. PROPERTY, PLANTS AND EQUIPMENT**

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

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

In 2007 we leased an aggregate of approximately 29,997 square feet of office space in Azour, Israel. In 2007, annual lease payments for this facility were approximately \$434,000. This lease expired on March 31, 2008 and was renewed by us for an additional 5 year period. These premises include our executive offices and the administrative and operational centers for our operations as well as our customer service, value-added services and technical support centers for the Israeli market.

In Buenos Aires, Argentina, we lease approximately 1,919 square feet of office space for approximately \$ 63,000 annually, approximately 213 square feet for our control center for approximately \$ 7,000 annually and approximately 1,595 square feet for our own installation center for approximately \$ 60,000 annually and approximately 656 square feet for our own warehouse for approximately \$ 14,000 annually, and approximately 361 square feet for third warehouses for approximately \$ 3,800 annually.

We lease approximately 7,500 square feet for our offices and control center in Florida for an approximate monthly rate of \$9,000, subject to a 3% annual increase.

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

The size of our base station sites varies from approximately one to eight square feet. In Israel, we have 96 base stations and we rent most base station sites independently for a monthly rate ranging from \$100 to \$1,400 per site depending on the location, size and other factors; for certain sites we do not pay any rent. The typical duration of a lease agreement for our base stations in Israel is five years and we generally have a right to renew the term of the lease agreements for a period ranging between two and five years. In Brazil, we have 102 base station sites, of which 33 sites are leased from the same entity for a monthly rate ranging from \$534 to \$1490 per site and the duration of each lease is 10 years. The remaining 69 sites are leased independently for an annual rate ranging from \$100 to \$685 depending on the location, size and other factors, and the typical duration for these leases is five years. In Argentina, we have 28 base station sites, all of which are leased from two entities for a monthly rate ranging from \$280 to \$640 per site. The duration of the lease ranges from two to three years. In Florida, we have 18 base station sites, leased primarily from property management companies. The annual rental rates vary from \$350,000 to \$400,000 and the duration of most leases is between three and five years, typically with options to renew for additional similar periods.

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

**ITEM 4.A. UNRESOLVED STAFF COMMENTS**

Not applicable.

**ITEM 5: OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

**A. OPERATING RESULTS**

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

**Introduction**

We believe we are a leading provider of location-based services, consisting predominantly of stolen vehicle recovery, which we refer to as SVR, and tracking services. We also provide wireless communications products used in connection with our SVR services and for various other applications. We currently provide our services and sell our products in Israel, Brazil, Argentina and the United States. In addition, in 2004 we have entered into contracts to deploy our automatic vehicle location, which we refer to as AVL, infrastructure and sell our end-units in China and South Korea, and commenced deploying such infrastructure in China in 2004 and in South Korea in 2005. In 2006, we began selling our products in China and South Korea, through Telematics (our recently sold subsidiary). For further details see Item 4.A. History and Development of the Company, under the caption *Our History* above.

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

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

Our wireless communications products segment consists of our short- and medium-range two-way wireless communications products that are used for various applications, including AVL. We sell our AVL end-units to customers that subscribe to our SVR services.

**Outlook**

We have historically experienced significant growth in the markets in which we provide our location-based services. Going forward, the Brazilian market continues to represent significant growth potential for our location-based services. These markets are characterized by high car theft rates and insurance companies that are seeking solutions to limit their actual losses resulting from car theft. The growth in subscribers within our location-based services segment also has a direct impact on the sale of our AVL products, as they are an integral component of our location-based services and are installed in each subscriber's vehicle.

As of December 31, 2007, we had approximately 232,000 subscribers in Brazil and Argentina. We estimate that the total addressable market in Brazil and Buenos Aires, Argentina is several million vehicles, and therefore we have a significant opportunity to grow our subscriber base and increase sales of our AVL products. In addition, we anticipate that utilizing the GPS/GPRS technology in Brazil may lead to a significant growth of our subscriber base.

We expect growth over the next 12 months in our location-based services segment to be driven by increased demand from existing insurance company customers in Brazil and Argentina, as a result of our strong operating results and their increased familiarity with and confidence in our services, as well as additional insurance companies who could seek to establish relationships with us, as well as increased direct sales of SVR services to individual subscribers in Brazil who, due to prevailing high insurance costs, are self-insured and represent an additional market opportunity for our SVR services and AVL products. In connection with such potential markets and additional growth opportunities, we are looking to enhance our brand recognition through additional advertising efforts that we started in 2004. We expect our growing representation in the SVR market in Brazil and Argentina to result in additional revenues from sales of our AVL products. We commenced providing SVR and fleet management services in Rio de Janeiro in 2006 and expect to increase revenues from such operations in future periods.

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**Geographical breakdown**

*Location-based services subscriber base*

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The following table sets forth the geographic breakdown of subscribers to our location-based services as of the dates indicated:

|                            | As of December 31, |                |                |                |
|----------------------------|--------------------|----------------|----------------|----------------|
|                            | 2007               | 2006           | 2005           | 2004           |
| Israel                     | 194,000            | 174,000        | 161,000        | 146,000        |
| Brazil                     | 135,000            | 125,000        | 107,000        | 75,000         |
| Argentina                  | 97,000             | 80,000         | 61,000         | 36,000         |
| United States              | 18,000             | 17,000         | 10,000         | 5,000          |
| <b>Total<sup>(1)</sup></b> | <b>444,000</b>     | <b>396,000</b> | <b>339,000</b> | <b>262,000</b> |

(1) All numbers provided are rounded down, and therefore totals may be slightly different than the results obtained by adding the numbers provided.

### Revenues

The following table sets forth the geographic breakdown of our revenues for each of our business segments for the relevant periods indicated.

|                            | Year ended December 31, |                                  |                         |                                  |                         |                                  |
|----------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|
|                            | 2007                    |                                  | 2006                    |                                  | 2005                    |                                  |
|                            | In USD, in Millions     |                                  |                         |                                  |                         |                                  |
|                            | Location based services | Wireless communications products | Location based services | Wireless communications products | Location based services | Wireless communications products |
| Israel                     | \$ 28.2                 | \$ 29.1                          | \$ 24.2                 | \$ 15.3                          | \$ 22.2                 | \$ 16.3                          |
| Brazil                     | 26.2                    | 6.9                              | 21.1                    | 4.8                              | 14.7                    | 6.3                              |
| Argentina                  | 8.4                     | 1.8                              | 6.9                     | 2.9                              | 5.6                     | 3.5                              |
| United States              | 1.8                     | 18.0                             | 1.8                     | 18.1                             | 1.6                     | 12                               |
| China                      |                         | 2.9                              |                         | 1.7                              |                         | 3.1                              |
| South Korea                |                         | 1.5                              |                         | 7.2                              |                         | 2.6                              |
| <b>Total<sup>(1)</sup></b> | <b>\$ 64.6</b>          | <b>\$ 60.2</b>                   | <b>\$ 54.0</b>          | <b>\$ 50.0</b>                   | <b>\$ 44.1</b>          | <b>\$ 43.8</b>                   |

(1) All numbers provided are rounded down, and therefore totals may be slightly different than the results obtained by adding the numbers provided.

The above table does not include revenues from our cellular services, which no longer constitute a reportable segment. See Note 20 to our consolidated financial statements appearing elsewhere in this report.

We attribute revenues to countries based on the location of the customer.

### Revenues

*Location-based services segment*

We generate revenues from sales of our SVR, fleet management and value-added services. A majority of our revenues represent subscription fees paid to us by our customers, predominately subscribers in Israel, Brazil and the United States, and insurance companies in Brazil and Argentina. We recognize revenues from subscription fees on a monthly basis. Our customers are free to terminate their subscription at any time. In the absence of such termination, the subscription term continues automatically. We also generate subscription fees from our fleet management services. Assuming no additional growth in our subscriber base and based on our historical churn rates of under 2% per month in this segment, we can anticipate that at least 90% of our subscription fees generated in a prior quarter will recur in the following quarter.

*Wireless communications products segment*

We generate revenues from the sale of our AVL products to customers in Israel, Brazil, Argentina, the United States, China and South Korea. We currently sell our AVL end-units in each of the above regions. Growth in our subscriber base is the principal driver for the sale of our AVL products. We recognize revenues from sales of our wireless communications products upon delivery.

**Cost of revenues**

*Location-based services segment*

The cost of revenues in our location-based services segment consists primarily of staffing, maintenance and operation of our control centers and base stations, costs associated with our staff and costs incurred for private enforcement, licenses, permits and royalties. Cost of revenues for sales of our fleet management services also includes payments to a third party who markets our services.

*Wireless communications products segment*

The cost of revenues in our wireless communications products segment consists primarily of production costs of our third-party manufacturers and costs associated with royalties and installation fees.

**Operating expenses**

*Research and development*

Our research and development expenses consist of salaries, costs of materials and other overhead expenses, primarily in connection with the design and development of our wireless communications products. We expense all of our research and development costs as incurred. As a result of the sale of our subsidiary, Telematics, we anticipate a decrease in such costs.

*Selling and marketing*

Our selling and marketing expenses have historically consisted primarily of advertising, salaries, commissions and other employee expenses related to our selling and marketing team and promotional and public relations expenses. We anticipate an increase in such costs, specifically in advertising costs related to our efforts to increase our subscriber base and enhance our brand recognition in Brazil and Argentina and to maintain our market leading position in Israel with respect to our location-based services and expenses related to the penetration of the GPS based products in all geographical areas of our operations.

*General and administrative*

Our general and administrative expenses consist primarily of salaries, bonuses, accounting and other general corporate expenses. We expect our general and administrative expenses to increase in future periods, in absolute terms, although we do not expect them to increase, as a percentage of our total revenues, due to the expansion of our business.

**Operating Income**

*Location-based services segment*

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Operating income in our location-based services segment is primarily affected by increases in our subscriber base and our ability to increase the resulting revenues without a commensurate increase in our corresponding costs. We expect this trend to continue in the foreseeable future.

### *Wireless communications products segment*

Operating income in our wireless communications products segment is primarily affected by our ability to increase sales of our AVL products. As a result of the sale of Telematics, our subsidiary, in 2007, the overall margin of our sales of wireless communication products has decreased.

### **Financing expenses, net**

Financing expenses, net, include short- and long-term interest expenses and gains and losses from currency fluctuations from dollar-denominated loans and the conversion of monetary balance sheet items denominated in currencies other than the dollar. Financing expenses, net, also include gains or losses from currency swaps and other derivatives that do not qualify for hedge accounting under FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, or which have not been designated as hedging instruments.

### **Taxes on income**

Income earned from our services and product sales is subject to tax in the country in which we provide our services or from which we sell our products. In Israel, the current corporate tax rate is 29%, however, this tax rate is expected to be reduced in the coming years.

### **Critical Accounting Policies and Estimates**

Our critical accounting policies are more fully described in Note 1 to our consolidated financial statements appearing elsewhere in this report. However, certain of our accounting policies require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. We evaluate our estimates on a periodic basis. We base our estimates on historical experience, industry trends, authoritative pronouncements and various other assumptions that we believe to be reasonable under the circumstances. Such assumptions and estimates are subject to an inherent degree of uncertainty.

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The following are our critical accounting policies and the significant judgments and estimates affecting the application of those policies in our consolidated financial statements. See Note 1 to our consolidated financial statements included elsewhere in this report.

#### Revenue recognition

We recognize revenues in accordance with Staff Accounting Bulletin No. 104 Revenue Recognition. For each of our segments we recognize revenues as follows:

- § from sales to subscribers of our location-based services, on a monthly basis;
- § from sales of our wireless communications products, when title and risk of loss of the applicable product pass to the relevant customer, which occurs upon delivery; and

We recognize revenues from certain long-term contracts in accordance with Statement of Position, which we refer to as SOP, 81-1, *Accounting for Performance of Construction-Type and Certain Production Type Contracts*. Pursuant to SOP 81-1, revenue is recognized pursuant to the percentage of completion method. We measure the percentage of completion based on output criteria in contracts that require network construction before end-units are sold, such as the number of end-units delivered or the progress of the work, based on input from engineers or other related professionals. Provisions for estimated losses on incomplete contracts are made during the period in which such losses are first identified, in the amount of the estimated loss on the entire contract. Until the end of 2007 such contracts were carried out by Telematics, which was sold by us in December 2007 for further description see Item 4.A. History and Development of our Company, under the caption *Our History* ) above.

We recognize revenues as gross or net in accordance with EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. In most of our business arrangements, we contract directly with our end-users, we are the primary obligor and we carry all risk of collections. Revenues under these arrangements are recorded on a gross basis.

Accounting for income taxes

As part of the process of preparing our consolidated financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process requires us to estimate our actual current tax exposure and make an assessment of temporary differences resulting from differing treatment of items, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, we establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the consolidated statement of income. Significant management judgment is required in determining our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We have recorded a valuation allowance of \$2.2 million in 2007, which indicates that our management cannot determine that it is more likely than not that we will be able to realize this tax asset in the future. In the event that we generate taxable income in the jurisdictions in which we operate and in which we have net operating loss carry-forwards, we may be required to adjust our valuation allowance.

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of *FASB Statement No. 109* (FIN 48). Fin 48 prescribes detailed guidance for the financial statements in accordance with FAS 109. Fin 48 contains two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefits as the largest amount that is more than 50% likely to be realized upon ultimate settlement. Significant judgment is required in making these determinations.

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Derivative instruments

We maintain a risk management strategy that incorporates the use of currency hedges to minimize significant fluctuations in cash flows and/or earnings that are caused by exchange rate volatility. As a result, we engage in transactions involving foreign exchange derivative financial instruments, principally forward exchange contracts, which are designed to hedge our expected cash flows from revenues resulting from subscription fees denominated in currencies other than NIS. Such transactions are designed to qualify as cash flow hedges under FAS No. 133. FAS No. 133 establishes accounting and reporting standards for derivative instruments (including certain derivative instruments embedded in other contracts). Changes in fair value of instruments that qualify for hedging accounting under FAS No. 133 are reported as other comprehensive income under gains in respect of derivative instruments designated for cash flow hedge, net of related taxes, and are recognized in the statements of income when the hedged transaction affects earnings. Derivatives which do not qualify for hedge accounting under FAS No. 133, or which have not been designated as hedging instruments, are recognized in the balance sheet at their fair value, with changes in the fair value carried to the statements of income and included in financing expenses, net.

Allowance for doubtful accounts

We are required to perform ongoing credit evaluations of our trade receivables and maintain an allowance for doubtful accounts, based upon our judgment as to our ability to collect outstanding receivables. In determining the relevant allowance amounts, we analyze our historical collection experience, current economic trends and the financial position of our customers. Our allowance policy is to define a flat percentage of our accounts receivable as the ongoing reserve and to reserve a higher amount for certain customers that we believe have a higher risk of default. In 2006 and 2007, our allowance for doubtful accounts was \$532,000 and \$754,000 and our trade receivables (net of allowance for doubtful accounts) were \$29.8 million and \$27.6, respectively. To date, based on our past experience, our allowances for doubtful accounts have been sufficient.

Goodwill and other intangible assets

Under FAS No. 142, *Goodwill and Other Intangible Assets*, goodwill acquired in a business combination is deemed to have indefinite life and is not to be amortized. FAS No. 142 requires goodwill to be tested for impairment on adoption and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired. Goodwill is tested for impairment by comparing the fair value of the reporting unit with its carrying value. Fair value is determined using the income approach. Significant estimates used in the methodologies included estimates of future cash flows and estimates of discount rates. We have performed impairment tests on our goodwill. In 2006, no impairment losses have been identified and in 2007 we wrote impairment losses of \$0.9 million. In 2006 and 2007, we had total goodwill of \$4.5 million and \$9.6, respectively, on our balance sheet. In assessing the recoverability of our goodwill and other intangible assets, we must make assumptions regarding the estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets.



## Results of Operations

The following table sets forth for the periods indicated selected items from our consolidated statements of operations as a percentage of our total revenues.

| Consolidated statements of operations data:  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2007                    | 2006         | 2005         |
| <b>Revenues:</b>                             |                         |              |              |
| Location-based services                      | 51.8%                   | 51.9%        | 49.0%        |
| Wireless communications products             | 48.2                    | 48.1         | 48.6         |
| Other  |                         |              | 2.4          |
| <b>Total revenues</b>                        | <b>100</b>              | <b>100</b>   | <b>100.0</b> |
| <b>Cost of revenues:</b>                     |                         |              |              |
| Location-based services                      | 18.9                    | 17.7         | 16.6         |
| Wireless communications products             | 35.3                    | 34.1         | 34.3         |
| Other  |                         |              | 1.9          |
| <b>Total cost of revenues</b>                | <b>54.2</b>             | <b>51.8</b>  | <b>52.8</b>  |
| <b>Gross profit</b>                          | <b>45.8</b>             | <b>48.2</b>  | <b>47.2</b>  |
| <b>Operating expenses:</b>                   |                         |              |              |
| Research and development expenses            | 2.4                     | 2.6          | 3.1          |
| Selling and marketing expenses               | 6.6                     | 4.9          | 5.4          |
| (General and administrative expenses, net)   | 18.1                    | 17.0         | 16.6         |
| Other income, net                            | (39.4)                  |              |              |
| <b>Total operating expenses (income)</b>     | <b>(12.3)</b>           | <b>24.5</b>  | <b>25.1</b>  |
| <b>Operating income</b>                      | <b>58.1</b>             | <b>23.7</b>  | <b>22.1</b>  |
| <b>Financing income, net</b>                 | <b>1</b>                | <b>1.8</b>   | <b>1.0</b>   |
| Other expenses, net                          |                         |              |              |
| <b>Income before taxes on income</b>         | <b>59.1</b>             | <b>25.5</b>  | <b>23.1</b>  |
| Taxes on income                              | (16.8)                  | (6.3)        | (5.9)        |
| Share in losses of affiliated companies, net | (0.4)                   | (0.2)        | (0.4)        |
| Minority interest in income of subsidiaries  | (0.6)                   | (0.5)        | (0.8)        |
| <b>Net income</b>                            | <b>41.3%</b>            | <b>18.5%</b> | <b>16.0%</b> |

### *Analysis of our Operation Results for the Year ended December 31, 2007 as compared to the year ended December 31, 2006*

#### Revenues

Total revenues increased from \$104.1 million in 2006 to \$124.8 million in 2007, or 19.9%. This increase consisted of \$10.6 million from subscription fees from our location-based services and \$10.1 million from sales of our wireless communications products.

*Location-based services segment*

Revenues in our location-based services segment increased from \$54 million in 2006 to \$64.6 million in 2007, or 19.6%. This increase was primarily due to an increase in the number of the average subscribers from approximately 368,000 in 2006 to approximately 420,000 in 2007, or 14.1%.

*Wireless communications products segment*

Revenues in our wireless communications products segment increased from \$50.0 million in 2006 to \$60.2 million in 2007, or 20.4%. This increase was primarily due to an increase in sales of our AVL products and consolidation of revenues by our subsidiaries ERM and MAPA in 2007. This increase was partially offset by a decrease in revenues from our deployment projects in China and South Korea.

**Cost of revenues**

Total cost of revenues increased from \$53.9 million in 2006 to \$67.6 million in 2007, or 25.6%. This increase consisted of an increase of \$5.2 million in our location-based services segment and \$8.5 million in our wireless communications products segment. As a percentage of total revenues, cost of revenues increased from 51.8% in 2006 to 54.2% in 2007.

*Location-based services segment*

Cost of revenues for our location-based services segment increased from \$18.4 million in 2006 to \$23.6 million in 2007, or 28.3%. This increase was primarily due to the increase in our subscriber base and as a result of an increase in depreciation expenses partially due to an increase in the lease of some of our AVL products and depreciation thereof over the term of lease. As a percentage of total revenues for this segment, cost of revenues increased slightly from 34.1% in 2006 to 36.5% in 2007.

*Wireless communications products segment*

Cost of revenues for our wireless communications products segment increased from \$35.4 million in 2006 to \$44 million in 2007, or 24.3%. As a percentage of total revenues for this segment, cost of revenues increased from 70.8% in 2006 to 73.1% in 2007, primarily as a result of a change in the marketing mix of our products, i.e. an increase in the sale of our AVL end-units and a decrease in our revenues from deployment projects in China and Korea.

**Operating expenses**

*Research and development*

Research and development expenses increased from \$2.7 million in 2006 to \$3 million in 2007, or 11%.

*Selling and marketing*

Selling and marketing expenses increased from \$5.1 million in 2006 to \$8.2 million in 2007, or 60.8%. This increase was due to an increase in the marketing and advertising expenses in order to penetrate the market in Israel for the GPS products as well as consolidation of the marketing and advertising expenses of our subsidiary Mapa which was consolidated for the first time in our financial statements for the year 2007 and ERM which was first consolidated during the month of December 2006. As a percentage of total revenues, selling and marketing expenses increased from 4.9% in 2006 to 6.6% in 2007.

*General and administrative*

General and administrative expenses increased from \$17.7 million in 2006 to \$22.6 million in 2007, or 27.7%. This increase was due to an increase in salary expenses of \$2.5 million mainly as a result of retention of additional employees and statutory increase in salaries. In addition, we incurred additional significant accounting, legal and other expenses in order to meet regulatory requirements such as Section 404 and other provisions of the Sarbanes-Oxley Act of 2002 as well as rules implemented under the SEC and The Nasdaq Global Market. The implementation and testing of such processes and systems required us to hire outside consultants and incur other significant costs. In addition, the increase in our general and administrative expenses was due to the consolidation of the general and administrative expenses of our acquired subsidiaries Mapa and ERM, which were consolidated in 2007. As a percentage of total revenues, general and administrative expenses increased from 17.0% in

2006 to 18.1% in 2007.

**Other Expenses (income), net**

Other income in the sum of approximately US\$49.1 million in 2007 resulted primarily from the sale of our subsidiary Telematics Wireless which was completed by us in December 31, 2007. For further details, please refer to Item 4..A History and Development of the Company, under the caption *Our History* above.

**Operating income**

Total operating income increased from \$24.7 million in 2006 to \$72.5 million in 2007. This increase was primarily attributed to the recognition of revenues of the Company from the sale of our subsidiary Telematics Wireless. Total operating income without other income in 2007 was \$23.4 million, a decrease of \$1.3 million which consisted of \$0.4 million decrease in our location-based services segment, and a \$0.9 million decrease in our wireless communications products segment. The decrease in our operating income in 2007 in our wireless communication products segment was mainly attributed to a decrease in our revenues from revenues from projects in China and Korea. The decrease in our operating income in 2007 in our location-based services segment was mainly attributed to an increase in our operating expenses as a result of our efforts to expand our operations in Brazil and an increase in our marketing expenses.

*Location-based services segment*

Operating income in our location-based services segment decreased from \$16.6 million in 2006 to \$15.5 million in 2007, or 6.6%. This decrease was primarily due to an increase in the operating expenses from \$18.4 million in 2006 to \$23.6 million in 2007, mainly as a result of substantial devaluation of the US dollar against the Israeli shekel (of approximately 8%) in 2007 which affected the operating expenses that are incurred in New Israeli Shekels and translated to US\$ while the revenues from subscription fees in Israel are in US Dollar.

*Wireless communications products segment*

Operating income in our wireless communications products segment decreased from \$8.0 million in 2006 to \$7.8 million in 2007. This minor decrease was due to a change in the marketing mix of our sales.

**Financing expenses (income), net**

Financing income, net decreased from \$1.9 million in 2006 to \$1.2 million in 2007 or 36.8%. This decrease was mainly due to a decrease in cash which were mainly utilized for payment of dividend and the acquisition of Mapa.

**Taxes on income**

Taxes on income increased from \$6.6 million in 2006 to \$21 million in 2007 (or to \$7.2 million in 2007 following deduction of tax from other income). This increase was primarily due to the increase in our taxable income over such period. Total income tax expense in 2006 was 24.7% of income fore tax, while in 2007 it was 28.4% of income before tax. This increase was primarily due to a one-time adjustment of tax for earlier years which was done in 2006 which caused a decrease in the tax burden in that year.

***Analysis of our Operation Results for the Year ended December 31, 2006 as compared to the year ended December 31, 2005***

**Revenues**

Total revenues increased from \$90.1 million in 2005 to \$104.1 million in 2006, or 15.5%. This increase consisted of \$9.9 million from subscription fees from our location-based services and \$6.2 million from sales of our wireless communications products. This increase was partially offset by a decline of \$2.2 million in sales of our cellular services resulting from the expiration of our agreement with Partner Communications as of March 31, 2005.

*Location-based services segment*

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Revenues in our location-based services segment increased from \$44.1 million in 2005 to \$54.0 million in 2006, or 22.4%. This increase was primarily due to an increase in the number of the average subscribers from approximately 300,000 in 2005 to approximately 368,000 in 2006, or 22.6%.

### *Wireless communications products segment*

Revenues in our wireless communications products segment increased from \$43.8 million in 2005 to \$50.0 million in 2006, or 14.1%. This increase was primarily due to an increase in sales of our AMR products and an increase in revenues from our deployment projects in China and South Korea, this increase was offset by a decrease in the AVL products as a results of free lease transactions in Brazil.

### *Other*

Revenues from our cellular services decreased from \$2.2 million in 2005 to none in 2006, this decrease was due to a decline in sales resulting from the expiration of our agreement with Partner Communications as of March 31, 2005.

### **Cost of revenues**

Total cost of revenues increased from \$47.6 million in 2005 to \$53.9 million in 2006, or 13.2%. This increase consisted of an increase of \$3.4 million in our location-based services segment and \$4.5 million in our wireless communications products segment. This increase was partially offset by a decline of \$1.6 million in sales of our cellular services. As a percentage of total revenues, cost of revenues decreased from 52.8% in 2005 to 51.8% in 2006.

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### *Location-based services segment*

Cost of revenues for our location-based services segment increased from \$15.0 million in 2005 to \$18.4 million in 2006, or 22.9%. This increase was primarily due to the increase in our subscriber base and due to our penetration to new region (Rio de Janeiro). As a percentage of total revenues for this segment, cost of revenues increase slightly from 34.0% in 2005 to 34.1% in 2006.

### *Wireless communications products segment*

Cost of revenues for our wireless communications products segment increased from \$31.0 million in 2005 to \$35.4 million in 2006, or 14.5%. As a percentage of total revenues for this segment, cost of revenues increased slightly from 70.7% in 2005 to 70.8% in 2006.

### *Other*

Cost of revenues from our cellular services decreased from \$1.6 million in 2005 to \$0 in 2006. This decrease was due to the decline in revenues resulting from the expiration of our agreement with Partner Communications as of March 31, 2005.

### **Operating expenses**

#### *Research and development*

Research and development expenses decreased from \$2.8 million in 2005 to \$2.6 million in 2006, or 7%.

#### *Selling and marketing*

Selling and marketing expenses increased from \$4.9 million in 2005 to \$5.1 million in 2006, or 5.1%. This increase was due to additional advertising expenses in Brazil and Argentina for the principal purpose of increasing our brand recognition in such markets. As a percentage of total revenues, selling and marketing expenses decreased from 5.4% in 2005 to 4.9% in 2006.

#### *General and administrative*

General and administrative expenses increased from \$15.0 million in 2005 to \$17.7 million in 2006, or 18.0%. This increase was due to an additional \$0.5 million of bonus payments to senior management, an increase in salary expenses of \$1 million as a result of the hiring of

additional employees, mainly in Brazil. As a percentage of total revenues, general and administrative expenses increased from 16.6% in 2005 to 17.0% in 2006. Additionally, we incurred additional significant accounting, legal and other expenses that we did not incur before our offering on the NASDAQ, such as costs associated with corporate governance requirements, including requirements under Section 404 and other provisions of the Sarbanes-Oxley Act of 2002, as well as rules implemented by the SEC and The Nasdaq Global Market. Such rules and regulations have lead to an increase in our legal and financial compliance costs, introduced new costs such as investor relations, stock exchange listing fees and shareholder reporting, and to made some activities more time consuming and costly. The implementation and testing of such processes and systems required us to hire outside consultants and incur other significant costs.

### **Operating income**

Total operating income increased from \$19.9 million in 2005 to \$24.7 million in 2006, or 24.1%. This increase consisted of \$3.6 million increase in our location-based services segment, a \$1.4 million increase in our wireless communications products segment, which was partially offset by a \$0.2 million decrease from our cellular services.

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#### *Location-based services segment*

Operating income in our location-based services segment increased from \$13.0 million in 2005 to \$16.6 million in 2006, or 27.8%. This increase was primarily due to an increase in our revenues from \$44.1 million in 2005 to \$54.0 million in 2006.

#### *Wireless communications products segment*

Operating income in our wireless communications products segment increased from \$6.6 million in 2005 to \$8.0 million in 2006. This increase was primarily due to an increase in revenues for this segment of \$6.2 million and an increase in cost of revenues of \$4.5 million (as a percentage of revenues from 70.7% in 2005 to 70.8% in 2006).

#### *Other*

Operating income from our cellular services declined from \$0.2 million in 2005 to \$0 in 2006. This decline was due to the expiration and the non-renewal of our agreement with Partner Communications as of March 31, 2005.

### **Financing expenses (income), net**

Financing income, net, increased from \$0.9 million in 2005 to \$1.9 million in 2006 or 111%. This increase was mainly due to our last IPO on September 2005.

### **Taxes on income**

Taxes on income increased from \$5.3 million in 2005 to \$6.6 million in 2006, or 24.3%. This increase was primarily due to the increase in our taxable income over such period. Total income tax expense in 2005 was 25.4% of pre-tax income, while in 2006 it was 24.7% of pre-tax income. This decrease is primarily due to the decrease in the applicable income tax rate in Israel from 34% in 2005 to 31% in 2006.

### **Impact of Currency Fluctuations on Results of Operations, Liabilities and Assets**

Although we report our consolidated financial statements in dollars, in 2005, 2006 and 2007, a portion of our revenues and expenses was derived in other currencies. For fiscal years 2005, 2006 and 2007, we derived approximately 48.9%, 53.2% and 47.3% of our revenues in dollars, 20.4%, 14.3% and 19.8% in NIS, 23.3%, 24.8% and 25.3% in Brazilian Reals and 7.4%, 7.6% and 7.6% in Argentine Pesos, respectively. In fiscal years 2005, 2006 and 2007, 44.2%, 42.9% and 35.7% of our expenses were incurred in dollars, 35.2%, 31% and 35.5% in NIS, 15.5%, 21.5% and 23.2% in Brazilian Reals and 5.1%, 4.6% and 5.6% in Argentine Pesos, respectively.

Exchange differences upon conversion from our functional currency to dollars are accumulated as a separate component of accumulated other comprehensive income under shareholders' equity. In 2007, accumulated other comprehensive income decreased/increased by \$10.7 million compared to the year 2006. In the year 2006, accumulated other comprehensive income decreased by \$6.4 million compared to the year 2005. In the year 2005, accumulated other comprehensive income increased by \$0.9 million compared to the year 2004. In 2004, accumulated other comprehensive income decreased by \$0.2 million compared to the year 2003. Exchange differences upon conversion from the functional currency from our other selling and marketing subsidiaries to dollars are reflected in our income statements under financing expenses, net.

The fluctuation of the other currencies in which we incur our expenses or generate revenues against the NIS or the dollar has had the effect of increasing or decreasing (as applicable) reported revenues, cost of revenues and operating expenses in such foreign currencies when converted into dollars from period to period. The following table illustrates the effect of the changes in exchange rates on our revenues, gross profit and operating income for the periods indicated:

| Year Ended December 31, |                                       |           |                                       |           |                                       |            |                                       |            |                                       |
|-------------------------|---------------------------------------|-----------|---------------------------------------|-----------|---------------------------------------|------------|---------------------------------------|------------|---------------------------------------|
| 2004                    |                                       | 2005      |                                       | 2006      |                                       | 2007       |                                       |            |                                       |
| Actual                  | At 2004 exchange rates <sup>(1)</sup> | Actual    | At 2004 exchange rates <sup>(1)</sup> | Actual    | At 2005 exchange rates <sup>(1)</sup> | Actual     | At 2006 exchange rates <sup>(1)</sup> | Actual     | At 2006 exchange rates <sup>(1)</sup> |
| (In thousands)          |                                       |           |                                       |           |                                       |            |                                       |            |                                       |
| Revenues                | \$ 77,926                             | \$ 77,263 | \$ 90,126                             | \$ 86,653 | \$ 104,052                            | \$ 101,605 | \$ 124,838                            | \$ 119,837 |                                       |
| Gross profit            | 36,038                                | 53,895    | 42,540                                | 40,761    | 50,199                                | 40,037     | 57,199                                | 55,021     |                                       |
| Operating income        | 18,263                                | 18,370    | 19,922                                | 19,065    | 24,732                                | 24,406     | 72,499                                | 72,781     |                                       |

(1) Based on average exchange rates during the period.

Our policy remains to reduce exposure to exchange rate fluctuations by entering into foreign currency forward transactions that qualify as hedging transactions under FAS No. 133, the results of which are reflected in our income statements as revenues. The result of these transactions, which are affected by fluctuations in exchange rates, could cause our revenues, gross profit and operating income to fluctuate.

In addition, due to increased fluctuations in the exchange rate of the US dollar vis-a-vis the Israeli Shekel in 2002, in December 2002 we commenced acquiring derivative financial instruments in order to convert currency fluctuation risks related to our US dollar denominated loans from the US dollar to other currencies which we thought would be more stable. Gains or losses from such derivative financial instruments do not qualify for hedge accounting under FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and are reflected in financing expenses, net. As of June, 2008, we have no more open positions on such derivative financial instruments and any remaining effects on our financial results from such derivative financial instruments are reflected in our financial results for the year 2007 and will not affect our results of operations for any subsequent period.

## B. LIQUIDITY AND CAPITAL RESOURCES

Since our inception, we funded our operations primarily from cash generated from operations, borrowings under our credit facilities with banks, proceeds from the initial public offering of our ordinary shares in Israel and the proceeds received from other public or private sales of our equity and debt instruments. In 2005, 2006 and 2007 we had \$58.4 million, \$59.8 million and \$38.2 million in cash and marketable securities and \$61 million, \$73.4 million and \$110.4 million in working capital, respectively. In addition, in 2005, 2006, we had \$3.5 million, \$0.3 million, respectively, of outstanding long-term borrowings from banks, of which \$3.1 million and \$0.3, respectively, were current. In 2007, we did not have any outstanding long-term borrowings from banks. In 2005, 2006 and 2007, we also had 1.1 million, \$1.4 million and \$1.4 million, respectively, available to us under existing lines of credit of which we were utilizing \$0.2 million in 2005, \$0.1 million in 2006 and \$0.3 million in 2007.

We believe that our cash flow from operations, availability under our lines of credit and cash and marketable securities will be adequate to fund our capital expenditures, contractual commitments and other demands and commitments for the foreseeable future as well as for the long-term. We believe that cash flow generated from operations and cash available to us from our credit facilities and the use of proceeds of the initial public offering of our shares in the USA, will be sufficient to cover future expansion of our various businesses into new geographical markets or new products, as currently contemplated and as we describe below. However, if existing cash and cash generated from operations are insufficient to satisfy our liquidity requirements, we may seek financing elsewhere by selling additional equity or debt securities or by obtaining additional credit facilities.

We had long-term liabilities in 2005, 2006 and 2007 of \$4.5 million, \$5.3 million and \$4.1, respectively, for employee pension costs for certain of our employees that become payable upon their retirement. Our Israeli employees are entitled to one month's salary, equal to the applicable monthly salary at the time of such employee's retirement, for each year of employment, or a portion thereof, upon retirement. This liability is partially funded by deposit balances maintained for these employee benefits in the amount of \$3.0 million, \$4 million and \$2.5 million in 2005, 2006 and 2007, respectively. The deposited funds include profits accumulated up to the balance sheet date and may be withdrawn upon the fulfillment of the obligation pursuant to Israeli severance pay laws or labor agreements.

As of December 31, 2007, we had outstanding capital notes. The holder of these capital notes and the Company are currently involved in legal proceedings over the terms of the notes. We believe that these notes may only be converted into approximately 2,802 of our ordinary shares (pre-split) and are not otherwise required to be repaid by us. The holder of these notes has made various alternative demands including the repayment in cash of the balance of the notes in the amount of approximately \$6.2 million (plus accrued interest and expenses) and the payment of a cash amount equal to the amount obtained by multiplying 1,172,154 of our ordinary shares (pre-split) by the highest trading price of our ordinary shares between the maturity date and the date of a court decision, plus interest and expenses. Although we cannot predict the outcome of the litigation proceedings at this time, if the holder of these notes prevails, the award of damages could result in significant costs to us. See Item 8.A. Consolidated Statements and other Financial Information under the caption Legal Proceedings below.

On January 29, 2004, we adopted a dividend policy providing for an annual dividend distribution in an amount equal to 25% of our net profits, calculated based on our financial statements for the period ending on December 31 of the fiscal year with respect to which the relevant dividend is proposed to be paid. Pursuant to such policy, we distributed NIS 11.8 million (approximately, \$2.7 million) on April 28, 2005, NIS 17.5 million (approximately, \$3.7 million), on April 4, 2006, NIS 20.1 million (approximately, \$4.8 million), on April 4, 2007 and NIS 108 million (approximately, \$30 million), on April 8, 2008.

On July 17, 2006, the board of the Company authorized the repurchase of ordinary shares up to \$10 million. On January 24, 2008, our board of directors authorized an increase of the amount of the shares to be repurchased by the Company, to repurchase up to an aggregate of \$20 million of ordinary shares of the Company. As of the date of this report, the Company repurchased 2,326,574 ordinary shares (of which 924,433 were purchased by its subsidiary, Ituran Cellular Communications Ltd.).

The following table sets forth the components of our historical cash flows for the periods indicated:

|  | Year ended December 31, |                    |                  |
|--|-------------------------|--------------------|------------------|
|  | 2007                    | 2006               | 2005             |
|  | (In thousands)          |                    |                  |
| Net cash provided by operating activities                    | \$ 12,761               | \$ 18,254          | \$ 17,758        |
| Net cash used in investing activities                        | (19,188)                | (29,940)           | (4,893)          |
| Net cash provided by (used in) financing activities          | (13,040)                | (8,162)            | 41,255           |
| Effect of exchange rate changes on cash and cash equivalents | 4,324                   | 5,231              | (295)            |
| <b>Net increase in cash and cash equivalents</b>             | <b>\$ 15,143</b>        | <b>\$ (14,617)</b> | <b>\$ 53,825</b> |

#### Years ended December 31, 2007, December 31, 2006 and December 31, 2005

##### *Net cash provided by operating activities*

Our operating activities provided cash of \$17.8 million in 2005, \$18.3 in 2006 and \$12.8 million in 2007.

The decrease of approximately \$5.5 million in cash from operating activities in 2007 as opposed to 2006 was due primarily to:

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Cash used for operating activities as follows:

- Increase in accounts receivable in an amount of approximately \$4.9 million;
- Decrease in other current liabilities in an amount of approximately \$4.7 million.

Cash from operating activities as follows:

- Increase in liabilities for employee rights upon retirement in an amount of approximately \$1.5 million;
- Decrease in other current assets in an amount of approximately \$2.4 million.

The increase of approximately \$0.5 million in cash from operating activities in 2006 as opposed to 2005 was due primarily to:

Cash from operating activities as follows:

- Increase in our net profit in an amount of approximately \$4.9 million;
- Increase in accounts payable in an amount of approximately \$2.2 million;
- Decrease in accounts receivable in an amount of approximately \$1.2 million.

Cash used for operating activities as follows:

- Increase in inventory and contracts in process in an amount of approximately \$4.2 million;
- Decrease in other current liabilities in an amount of approximately \$2.3 million.

The minor increase of approximately \$0.1 million in cash from operating activities in 2005 as opposed to 2004 was due primarily to:

Cash from operating activities as follows:

- Increase in our net profit in an amount of approximately \$3.2 million;
- Increase in other current liabilities in an amount of approximately \$1.2 million;
- Decrease in inventory and contracts in process in an amount of approximately \$1 million.

Cash used for operating activities as follows:

- Decrease in accounts receivable in an amount of approximately \$1.9 million;
- Decrease in accounts payable in an amount of approximately \$2.1 million;
- Decrease in deferred taxes in an amount of approximately \$0.9 million;
- Decrease in deferred revenue balances in an amount of approximately \$0.7 million;

*Net cash used in investing activities*

Net cash used in investing activities in 2007 in an amount of approximately \$19.2 was used primarily for the purchase of fixed assets in an amount of \$9.6 million and the acquisition and sale of subsidiaries and affiliates in the amount of \$16.9 million, which were partially funded from sale of securities in the amount of \$8.5 million.

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Our investing activities used cash of \$29.9 million in 2006 primarily due to the purchase of fixed assets in the amount of \$12.1 million (of which \$3.3 million was used to acquire the office building in Brazil), investment in securities in the amount of approximately \$15 million and the acquisition of a subsidiary for the amount of approximately \$2.2 million. Our investing activities used cash of \$4.9 million in 2005 primarily due to the purchase of property and equipment and purchase of intangible assets and minority interest for \$4.3 million and an increase in funds with respect to employee rights upon retirement of \$0.3 million.

*Net cash provided by (used in) financing activities*

Net cash used in financing activities in 2007 in an amount of approximately \$13 million consisted primarily of a long-term loan repayment in the amount of \$3.5 million, a cash dividend payment in the amount of \$4.8 million and purchase of treasury shares in an amount of \$4.9 million.

Our financing activities used cash of \$8.2 million in 2006 primarily from a long term loan prepayment in the amount of \$3.2 million, a cash dividend payment in the amount of \$3.7 million and purchase of treasury shares in the amount of \$0.9 million. Our financing activities provided cash of \$41.3 million in 2005 primarily from issuance of capital shares of \$50 million which was partially offset by repayment of our short-term and long-term loans totaling \$6.3 million and a dividend payment of \$2.7 million paid during such period.

### C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES





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|                 |    |  |
|-----------------|----|--|
| Izzy Sheratzky  | 62 | Chairman of the Board of Directors                         |
| Yehuda Kahane   | 64 | Director   |
| Zeev Koren(1)   | 63 | Director   |
| Avner Kurz      | 55 | Director   |
| Amos Kurz       | 52 | Director   |
| Yigal Shani     | 64 | Director   |
| Eyal Sheratzky  | 40 | Co-Chief Executive Officer and Director                    |
| Nir Sheratzky   | 36 | Co-Chief Executive Officer and Director                    |
| Gil Sheratzky   | 31 | Director   |
| Yoav Kahane     | 34 | Director   |
| Orna Ophir(1)   | 58 | Director   |
| Israel Baron(1) | 55 | Director   |
| Eli Kamer       | 42 | Executive Vice President, Finance; Chief Financial Officer |
| Guy Aharonov    | 43 | General Counsel  |

(1) Member of our audit committee and an independent director under the Nasdaq National Market listing requirements.

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*Izzy Sheratzky* is a co-founder of our company and has served as the Chairman of our Board of Directors, which in our company constitutes both an officer and director position, ever since our company was acquired from Tadiran in 1995. Until 2003, Mr. Sheratzky also served as our Chief Executive Officer. Mr. Sheratzky also serves as the Chairman of the Board of Directors of Telematics Wireless, Moked (1973) Investigations Company Ltd., Moked Services, Information and Investments Ltd., and Moked Ituran. He also serves as a director in Tikal Document Collection Ltd. Mr. Sheratzky is the father of Eyal, Nir and Gil Sheratzky.

*Yehuda Kahane* is a co-founder of our company and has served as a director since its acquisition from Tadiran in 1995. Professor Kahane is a full-time professor at the Faculty of Management, Tel Aviv University. Professor Kahane founded and served as the first Dean of the Israeli Academic School of Insurance until 2000. In addition, he was the co-founder and co-owner of the managing firm of the first balanced pension fund in Israel, Teshura, a co-owner of the technological incubators Weizman, Ofakim and Katzrin, and is involved in the formation, seed investment and management of start-up companies. Professor Kahane serves as an actuarial consultant to various companies and organizations, and has been providing financial consulting services to our company since 1998. Professor Kahane also serves as a director of Telematics Wireless and of Moked Ituran. He is a director in Tachlit Investment House Ltd. and Capital Point Ltd. and in a large number of private technological companies unrelated to us. He is the chairman of an association for the visually impaired of Hertzelia and Sharon District and a board member of the umbrella organization for the visually impaired in Israel. Professor Kahane holds a BA degree in Economics and Statistics, an MA degree in Business Administration and a PhD in Finance from the Hebrew University of Jerusalem. He is the father of Yoav Kahane.

*Zeev Koren* has served as a director of our company since 2006. In 1988 Brigadier Gen. (Res) Koren retired from the Israel Defense Forces after a career of 25 years, where in his final position he served as the head of human resources planning for the general staff division. Since then he has served in senior capacity in companies in the fields of international forwarding and medical services. He holds a B.A. in Political Science and Criminology from Bar Ilan University.

*Avner Kurz* has served as a director of our company since its acquisition in 1995. Mr. Kurz is the Chairman and director of F.K. Generators & Equipment Ltd. and serves as a Chief Executive Officer of Teleran Holding, our subsidiary in Brazil. Mr. Kurz also serves as a director of Telematics Wireless, El-Ram, Moked Ituran, Totam Plus, Expandis and several other private companies abroad. Mr. Kurz is the brother of Amos Kurz.

*Amos Kurz* has served as a director of our company since its acquisition in 1995. Mr. Kurz also serves as a director of Telematics Wireless, and as Chief Executive Officer and director of F.K. Generators & Equipment. Mr. Kurz is the brother of Avner Kurz.

*Yigal Shani* has served as a director of our company since its acquisition in 1995. Mr. Shani is an insurance agent and a partner in the insurance agency Tzivtit Insurance Agency (1998), Ltd., which provides insurance services to our company. Mr. Shani also serves as a director of Gir Magen.

*Eyal Sheratzky* has served as a director of our company since its acquisition in 1995 and as a Co-Chief Executive Officer since 2003. Prior to such date, he served as an alternate Chief Executive Officer of our company in 2002 and as Vice President of Business Development during the years 1999 through 2002. Mr. Sheratzky also serves as a director of Moked Ituran and certain of our other subsidiaries, including Telematics Wireless, Ituran Network and Ituran Cellular Communication. From 1994 to 1999, he served as the Chief Executive Officer of Moked Services, Information and Investments and as legal advisor to several of our affiliated companies. Mr. Sheratzky holds LLB and LLM degrees from Tel

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Aviv University School of Law and an Executive MBA degree from Kellogg University. Mr. Sheratzky is the son of Izzy Sheratzky, the brother of Nir and Gil Sheratzky.

*Nir Sheratzky* has served as a director of our company since its acquisition in 1995 and as a Co-Chief Executive Officer since 2003. Prior to such date, Mr. Sheratzky served as alternate Chief Executive Officer of our company from 1995 to 2003. Mr. Sheratzky is also a director of Telematics Wireless and of Moked Ituran. He holds BA and MA degrees in Economics from Tel Aviv University. Nir is the son of Izzy Sheratzky, the brother of Eyal and Gil Sheratzky.

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*Gil Sheratzky* has served as a director of our company and as our advertising officer since 2003. Since January 23, 2007, he has served as well as CEO of our subsidiary, E-Com Global Electronic Commerce Ltd. Prior to such date, he worked in our control center during the years 2000 and 2001, and during the years 2001 and 2002, he worked in an advertising agency. Mr. Sheratzky holds a BA degree in Business Management from the Interdisciplinary Center, Herzlya. Mr. Sheratzky is the son of Izzy Sheratzky, the brother of Eyal and Nir Sheratzky.

*Yoav Kahane* has served as director of our company since 1998 and also serves as a director of Telematics Wireless. Since January 2006, Mr. Kahane serves as SBU Manager of Enzymotec Ltd. a biotechnology company. Prior to that, during the years 2004-2005, Mr. Kahane served as Vice President of Sales and Marketing in Elbit Vision Systems Ltd. Prior to that date, during the years 2001 and 2002, he served as Manager of Business Development in Denver Holdings and Investments Ltd. In 2000, Mr. Kahane established Ituran Florida Corp. and served as its Chief Executive Officer until 2001. Mr. Kahane has been providing consulting services to our company since 2004. Mr. Kahane holds BSc degree in Life Sciences from Tel-Aviv University, a BA degree in Insurance and an MBA degree from the University of Haifa. Yoav Kahane is the son of Professor Kahane.

*Orna Ophir* has been serving as an external director of our company since 2003 and is a member of our audit committee. Dr Ophir has been serving as Medical Director of Assuta hospitals in Israel since November 2004 and as Chief Executive Officer of the Golden Tower Hospital (Bat Yam, Israel) since 2001. Prior to such date, Dr Ophir served as Executive Vice President of Assuta Hospital (Tel Aviv, Israel) during the years 1997 to 2000. In addition, Dr Ophir is a director of Macabi Health Services, one of the principal health providers in Israel. Dr Ophir holds MD and MBA degrees from Tel Aviv University.

*Israel Baron* has been serving as an external director of our company since 2003 and is a member of our audit committee. Mr. Baron has been serving as Chief Executive Officer of several public sector employee retirement and saving plans since 2003. Prior to such date, Mr. Baron managed an organizational consulting firm, served as an investment manager in the Isaac Tshuva group during the years 1999 to 2001 and as Chief Executive Officer of Gmulot Investment Company Ltd. Mr. Baron serves as director of Quality Baron Management Services Ltd. and until 2004 he served as a director of Brill Shoe Industries Ltd. Mr. Baron is a certified CPA and holds a BA degree in Economics and Accounting.

*Eli Kamer* has served as Executive Vice President, Finance and Chief Financial Officer of our company since 1999, after serving as its Finance Department Manager since 1997. Prior such date, Mr. Kamer worked as an accountant in Fahn Kanne & Co., our independent auditors. Mr. Kamer is a CPA and holds a BA degree in Business Administration from the Israel College of Management and an MBA degree in business administration from Bar Ilan University.

*Guy Aharonov* has served as our in-house legal counsel since 1999. Prior to joining our company, he has worked as an attorney in Cohen Lahat & Co. Mr. Aharonov holds LLB and LLM degrees from Tel Aviv University.

Our articles of association provide for staggered three-year terms for all of our directors. The directors on our Board (excluding the external directors) are divided into three classes, and each class of directors will serve for a term of three years. Our independent directors who also qualify as external directors under the Israeli Companies Law, Orna Ophir and Israel Baron, are serving three-year terms in accordance with Israeli law. In April 2006 our general meeting of shareholders approved the extension of term of office of our external directors, for an additional term of three years (until June 3, 2009) under the same terms of the initial term of office.

### **B. COMPENSATION**

The aggregate direct compensation we paid to our directors who are not officers for their services as directors as a group for the year ended December 31, 2007 was approximately \$44,000. Directors are reimbursed for expenses incurred in connection with their attendance of board or committee meetings.

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The aggregate compensation paid to our Co-Chief Executive Officers in 2007 was \$696,000. Our four highest paid officers in 2007, other than our Co-Chief Executive Officers, were the active Chairman of our Board of Directors, who was paid \$1,562,000 in 2007, and our Vice President, IT and Systems Operation, our Purchase and Logistics Manager, Vice President of sites who were paid \$203,000, \$183,000 and \$182,000, respectively. The aggregate compensation paid to all Ituran officers as a group during 2007 was \$3,672,000. In 2007, we also paid an aggregate amount of \$45,000 to a director for services provided to us and employment compensation in an aggregate amount of \$230,000 to three directors who are our employees but are not Ituran officers. These compensation amounts include amounts attributable to automobiles made available to our officers and other fringe benefits commonly reimbursed or paid by companies in Israel. Employee directors do not receive additional fees for their services as directors. During 2007, we set aside \$181,000 for the benefit of our officers for pension, retirement or similar benefits. We do not set aside any funds for the benefit of our directors who are not employees for any pension, retirement or similar benefits. All numbers in this paragraph are rounded to the nearest thousand.

Messrs. Izzy Sheratzky, Eyal Sheratzky and Nir Sheratzky provide their services as Chairman of our Board of Directors and Co-Chief Executive Officers, respectively, as independent contractors pursuant to services agreements between the company and A. Sheratzky Holdings Ltd., a company controlled by Izzy Sheratzky. Mr. Gil Sheratzky is employed as CEO of one of our subsidiaries, E-Com Global Electronic Commerce Ltd. See Item 7.B. Related Parties Transactions under the caption Transactions with Related Parties below.

The compensation paid to Mr. Izzy Sheratzky included a bonus in an amount equal to 5% of our profits before tax (including the share of affiliated companies net and minority interests in (income) loss of subsidiaries), on a consolidated basis, based on our audited consolidated financial statements for the relevant year, to which Mr. Izzy Sheratzky is entitled pursuant to his services agreement with the company. The compensation paid to each of our Co-Chief Executive Officers, Eyal Sheratzky and Nir Sheratzky, includes a bonus in an amount equal to 1% of our profits before tax, on a consolidated basis, based on our audited consolidated financial statements for the relevant year, granted pursuant to a resolution of our Board of Directors from January 2004. The compensation paid to Gil Sheratzky by our subsidiary E-Com Global Electronic Commerce Ltd. includes a bonus in an amount equal to 2% of the annual increase in that company's profits before tax, (up to a maximum amount of 1% of that company's profits before tax) based on its audited consolidated financial statements for the relevant year, beginning January 1, 2007. See Item 7 Related Parties Transactions under the caption Transactions with our directors and principal officers below.

We do not have any agreements with directors providing for benefits upon termination of their respective employment.

#### Shareholders Agreement and Articles of Association of Moked Ituran

On May 18, 1998, a shareholders agreement was entered into between Moked Ituran Ltd. and each of Moked's shareholders, Moked Services, Information, Management and Investments Ltd. (38%), F.K. Generators and Equipment Ltd. (26%), Yehuda Kahane Ltd. (26%), Gideon Ezra, Ltd. (2.5%), T.S.D. Holdings Ltd. (3.75%) and G.N.S. Holdings Ltd. (3.75%). On May 18, 1998, Moked's articles of association were amended to incorporate some of the provisions of the shareholders agreement as well as other provisions governing the relationship of its shareholders. The Moked articles were amended again on September 6, 2005 to correspond to an amendment to the shareholders agreement that was entered into on such date.

Gideon Ezra, Ltd. is a company controlled by Gideon and Hanna Ezra with each owing 50% of the capital stock of such company. Moked Services, Information, Management and Investments is a company owned by A. Sheratzky Holdings Ltd. (a company controlled by Izzy Sheratzky) (66.6%) and Benjamin Ron's heirs (2003) Ltd. (a company controlled by Ron Benjamin's heirs) (33.3%). F.K. Generators and Equipment is a company controlled by Perfect Quality Trading Ltd. (51%), a company owned by Avner Kurz and Amos Kurz in equal parts. Yehuda Kahane Ltd. is a company owned by Professor Kahane and Rivka Kahane. T.S.D. Holdings is a company controlled by Efraim Sheratzky. G.N.S. Holdings is a company controlled by Yigal Shani.

The shareholders agreement (as amended) and Moked's amended articles of association provide as follows:

- § Prior to the time a shareholders meeting of our company takes place, a separate meeting of the shareholders of Moked will be convened.
- § At the Moked shareholders meeting, all matters included in our meeting's agenda will be discussed and voted on.
- § The required quorum in the Moked meeting will be any number of the shareholders actually present. The resolutions will be adopted by a majority of the votes present and voting is based on the relative shareholdings in Moked, with the exception of

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Moked Services, Information, Management and Investments, which is entitled to 41.5% of the voting rights, thereby decreasing the voting rights of F.K. Generators and Equipment to 22.5% on the vote of any matter other than issues in which Izzy Sheratzky has a direct or indirect interest.

- § With respect to director elections, every Moked shareholder holding at least 3.5% of Moked's shares is entitled to designate one director in our annual shareholders meeting. Each Moked shareholder holding over 10% of Moked's shares may nominate an additional director for every additional 10% of Moked shares held by him or her in excess of the initial 10%. For the purpose of nominating additional directors, shareholdings may be aggregated.
- § As discussed in Board of Directors in Item 6.C Board Practices below, our directors (excluding the external directors) are divided into three classes as follows: class A Amos Kurz, Yoav Kahane, Eyal Sheratzky and Yigal Shani (with their term of office renewed until 2010), class B Yehuda Kahane, Avner Kurz and Nir Shertatzky (with their term of office expiring in 2008); and class C Gil Sheratzky, Zeev Koren and Izzy Sheratzky (with their term of office expiring in 2009).
- § Upon the expiration of the term of office of our class A directors, each of Moked Services, Information and Investment, provided it holds at least 40% of the voting rights (together with the 3.5% of the voting rights held by F.K. Generators and Equipment), Yehuda Kahane Ltd., provided it holds at least 20% of the voting rights, F.K. Generators and Equipment, provided it holds at least 20% of the voting rights, and Yigal Shani or G.N.S. Holdings, provided either of them holds at least 3.5% of the voting rights, shall be entitled to require Moked to appoint one director to class A. Upon the expiration of the term of office of the directors in class B, each of Moked Services, Information and Investment, provided it holds at least 40% of the voting rights (together with the 3.5% of the voting rights held by F.K. Generators and Equipment), and Yehuda Kahane, provided it holds at least 20% of the voting rights, and F.K. Generators and Equipment, provided it holds at least 20% of the voting rights, shall be entitled to require Moked to appoint one director to class B. Upon the expiration of the term of office of the directors in class C, (i) Moked Services, Information and Investment, provided it holds at least 36.5% of the voting rights shall be entitled to require Moked to appoint two directors and (ii) Efraim Sheratzky or T.S.D. Holdings, provided either of them holds at least 3.5% of the voting rights, shall be entitled to require Moked to appoint one director to class C.
- § Moked has agreed to vote all of its shares at our shareholders meetings in accordance with the resolutions adopted at the Moked shareholders meeting or, with regard to director elections, as described above. In the event of a tie with respect to a certain issue, Moked has agreed to vote its shares against the relevant resolution at our shareholders meeting.
- § Moked's shareholders have a right of first refusal on any sale of our shares by Moked. This right does not apply to open market sales by Moked of up to 2% of the issued share capital of our company in any given calendar year.
- § According to Moked's articles of association, each of the shareholders of Moked may direct Moked to dispose of a portion of Moked's holdings in our company that corresponds to such shareholders' proportional holdings in Moked and to distribute the proceeds of such disposition to such directing shareholders.

This shareholders agreement is in effect only for as long as Moked holds at least 20% of our issued and outstanding share capital. We expect Moked to continue to hold at least 20% of our issued and outstanding share capital following the consummation of this offering.

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### C. BOARD PRACTICES

#### Board of Directors

Currently, pursuant to our articles of association as presently in effect, our Board of Directors consists of twelve directors, including two external directors in accordance with Israeli law and three independent directors in accordance with the listing requirements of the Nasdaq National Market. Pursuant to our articles of association, other than the external directors, for whom special election requirements apply (see

External directors below), our directors are elected and may in certain circumstances be removed by the majority of our shareholders. Our articles of association provide for staggered three-year terms for all of our directors. The directors on our Board (excluding the external directors) are divided into three classes, and each class of directors will serve for a term of three years. The term of office of the directors assigned to class A has expired at our annual meeting of shareholders held in 2007 and was renewed for a further term of three years, until the annual meeting of shareholders to be held in 2010, and at each third succeeding annual meeting thereafter. The term of office of the directors assigned to class B will expire at the annual meeting of shareholders to be held in 2008, and at each third succeeding annual meeting thereafter. The term of office of the directors assigned to class C will expire at the annual meeting of shareholders to be held in 2009, and at each third succeeding annual meeting thereafter. This classification of the Board of Directors may delay or prevent a change of control of our company or in our management. The external directors, under Israeli law, serve a three-year term which may be extended for an additional term of three years. Our directors may at any time and from time to time appoint any other person as a director to fill a vacancy until the general meeting of shareholders in which the term of service of the replaced director was scheduled to expire. External directors may be removed from office pursuant to the terms of the Israeli Companies Law, 5759-1999, which we refer to as the Israeli Companies Law. See External directors below.

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Pursuant to the Israeli Companies Law, our chairman convenes and presides over the meetings of the Board. In addition, any two directors may convene a meeting of the Board of Directors. A quorum consists of a majority of the members of the Board, and decisions are taken by a vote of the majority of the members present. Our articles of association provide that such quorum will in no event be less than two directors.

The Israeli Companies Law provides that an Israeli company may, under certain circumstances, exculpate an office holder from liability with respect to a breach of fiduciary duties.

We are incorporated in Israel and in addition to being listed on the Nasdaq National Market, we are also listed on the Tel Aviv Stock Exchange, and therefore subject to various corporate governance requirements pursuant to Israeli law relating to external directors, our audit committee and our internal auditor.

### External directors

Under Israeli law, the board of directors of companies whose shares are publicly traded are required to include at least two members who qualify as external directors. External directors must be elected by the vote of a majority of the shares present and voting at a shareholders meeting provided that either:

- § such majority includes at least one-third of the shares held by all non-controlling shareholders present and voting at such meeting; or
- § the total number of shares voted against the election of the external director and held by shareholders other than controlling shareholders must not exceed 1.0% of the shares whose holders are entitled to vote at any meeting of shareholders.

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External directors are elected to serve an initial term of three years and may be re-elected to serve in that capacity for an additional three years. The term of office for external directors for Israeli companies traded on certain foreign stock exchanges, including the NASDAQ, may be extended indefinitely in increments of additional three-year terms. External directors may be removed from office by the same percentage of shareholders required for their election or by a court, in each case, only under limited circumstances, including ceasing to meet the statutory qualification for their appointment or violating the duty of loyalty to the company. If all directors are of the same gender, the next external director elected must be of the other gender. Each committee of the board of directors must include at least one external director, except that the audit committee must include all external directors then serving on the board of directors. Israeli law regulating the compensation of external directors prohibits external directors from receiving, directly or indirectly, any compensation other than for services as an external director pursuant to the provisions and limitations set forth in the regulations promulgated under the Israeli Companies Law.

Israeli law provides that a person is not qualified to serve as an external director if, at any time during the two years preceding his or her appointment, that person, a relative, partner or employer of that person, or any entity under that person's control has had any affiliation or business relationship with the company, any entity controlling the company or an entity that, as of the date of appointment, or at any time during the two years preceding that date, is controlled by the company or by any entity controlling the company. In addition, no person may serve as an external director if that person's professional activities create, or may create, a conflict of interest with that person's responsibilities as a director or otherwise interfere with that person's ability to serve as a director. Until the lapse of two years after termination of an external director's membership on a board of directors, such company may not engage an external director to serve as an executive officer or director and cannot employ or retain that person to provide paid professional services, whether directly or indirectly.

Dr. Ophir and Mr. Baron have been elected as our external directors through 2006, and were reelected by our shareholders for one additional three-year term expiring June 2009. In addition, Mr. Zeev Koren was elected as an independent director in 2006.

### Audit committee

Under Israeli law, the board of directors of a public company must appoint an audit committee. The audit committee must comprise of at least three directors, including all of the external directors. The audit committee may not include the chairman of the board, any director who is employed by the company or regularly provides services to the company (other than as a board member), a controlling shareholder or any relative of such person.

Our Board of Directors has formed an audit committee that is empowered to exercise the powers of the Board of Directors for our accounting, reporting and financial control practices. The members of the audit committee are Dr. Orna Ophir and Messrs. Israel Baron and Zeev Koren. Our Board of Directors has determined that Mr. Israel Baron is the committee's financial expert, as such term is defined by the rules of the Nasdaq National Market and the Securities and Exchange Commission.

### Compensation committee

Our Board of Directors has appointed a Compensation Committee, pursuant to the listing requirements of the Nasdaq National Market. The members of the Compensation Committee are Orna Ophir, Israel Baron and Ze'ev Koren. The Compensation Committee of our Board of Directors recommends the review and oversees the salaries, benefits and stock option plans for our employees, consultants, directors and other individuals whom we compensate. The Compensation Committee also administers our compensation plans. Our Board of Directors has determined that each member of the Compensation Committee is independent.

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### Internal auditor

The board of directors of an Israeli public company must appoint an internal auditor nominated by the audit committee. An internal auditor may not be:

- § a person (or a relative of a person) who holds more than 5% of the company's shares;
- § a person (or a relative of a person) who has the power to appoint a director or the general manager of the company;
- § an executive officer, director or other affiliate of the company; or
- § a member of the company's independent accounting firm.

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 procedures. Our internal auditor is Simon Yarel, CPA.

### The Sarbanes-Oxley Act of 2002 and the Nasdaq National Market listing standards

The Sarbanes-Oxley Act of 2002, as well as related new rules subsequently implemented by the Securities and Exchange Commission, requires foreign private issuers, such as us, to comply with various corporate governance practices. In addition, Nasdaq has adopted amendments to its requirements for companies that are listed on the Nasdaq National Market. Nasdaq Marketplace Rule 4350 was amended to permit foreign private issuers, such as us, to follow certain home country corporate governance practices without the need to seek an individual exemption from Nasdaq.

In reliance upon Nasdaq Marketplace Rule 4350(a)(1), as a foreign private issuer, we have elected to follow our home country practices, absent home country rules requiring otherwise, in lieu of certain Nasdaq Marketplace Rules. Specifically, in Israel, it is not required that a public company have (i) a majority of its board of directors be independent, as defined in Marketplace Rule 4350(c), (ii) an audit committee comprised solely of members who are able to read and understand fundamental financial statements as required by Nasdaq Marketplace Rule 4350(d)(2) or (iii) a nominating committee as required by Nasdaq Marketplace Rule 4350(c)(4). As a result, we have elected to follow Israeli law regarding independence requirements of our Board of Directors and the composition of our Board of Directors will remain as is. See External directors above. Similarly, we have elected to follow Israeli law with regard to the composition of our existing audit committee, which has three independent (as defined in Marketplace Rule 4350(c)) members, two of whom are external directors under the Israeli Companies Law and meet the requirements of Nasdaq Marketplace Rule 4350(d)(2) and at least one of which meets the requirement of the Directive of the Israel Securities Authority that one non-employee member has financial and accounting skills to, among other things, understand, on a high level, matters relating to business, accounting, internal auditing and financial statements. See also Audit Committees above. In addition, our Board of Directors will not appoint a nominating committee as required by Nasdaq Marketplace Rule 4350(c)(4) and, instead, elects to follow Israeli law, which provides that a company may determine its method of nominating its directors. In our case, Board of Director members (other than the External Directors) are nominated by our Board of Directors, as is the custom in Israel. By law, shareholders holding at least 1% of a company's voting rights may nominate directors and our company complies with this law. External Directors are nominated by the board of directors and must be elected at the shareholders general meeting that must approve them by a majority and in addition, either (i) one third of the non-controlling shareholders participating in such vote have voted for such External Directors; or (ii) the shareholders opposing such nomination that are not controlling shareholders must not represent in excess of 1% of the total voting rights in the company.

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**D. EMPLOYEES**

The following table sets forth the total number of our subsidiaries employees at the end of each of the past three years, and a breakdown of persons employed by main category of activity and geographic location:

|   | Year Ended December 31, |            |            |
|---|-------------------------|------------|------------|
|   | 2007                    | 2006       | 2005       |
| <b>By area of activity:</b>                   |                         |            |            |
| Control Center                                | 232                     | 239        | 195        |
| Research and Development                      | 12                      | 38         | 36         |
| Sales and Marketing                           | 75                      | 72         | 62         |
| Technical support and IT                      | 228                     | 105        | 100        |
| Finance, Administration and Management        | 179                     | 283        | 259        |
| Private enforcement and operations            | 344                     | 132        | 130        |
| <b>Total</b>                                  | <b>1,070</b>            | <b>869</b> | <b>782</b> |
| <b>By geographic location (out of total):</b> |                         |            |            |
| Israel  | 500                     | 416        | 397        |
| Brazil  | 381                     | 290        | 222        |
| Argentina                                     | 164                     | 138        | 138        |
| United States                                 | 25                      | 25         | 25         |
| <b>Total:</b>                                 | <b>1,070</b>            | <b>869</b> | <b>782</b> |

We consider our relations with our employees to be satisfactory and have no ongoing major labor disputes or material labor-related litigation. Our employees are subject to local labor laws and regulations, which in some countries are more stringent than others. Some of our senior executives also have employment agreements that may grant them rights in excess of those provided by the applicable laws.

**Israel**

Our employees in Israel are subject to Israeli labor laws and regulations and employment customs. The applicable labor laws and regulations principally concern matters such as paid annual vacation, paid sick days, length of the workday, payment for overtime and severance pay. Israeli law generally requires severance pay equal to one month's salary for each year of employment upon retirement or death of an employee or termination of employment without cause. Furthermore, 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. Since January 1, 1995, these amounts also include payments for national health insurance.

In addition, by order of the Israeli Ministry of Labor and Welfare, the provisions of several collective bargaining agreements between Telematics Wireless, the Histadrut and the Industrialists Association in Israel may be applicable to a segment of our employees other than managerial, finance and administrative, and marketing and sales personnel. However, we believe we provide our employees with benefits and working conditions that are at least as favorable as the conditions specified in these collective bargaining agreements.

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**Brazil**

Our employees in Brazil are subject to Brazilian labor laws and regulations and employment customs. The laws and regulations in Brazil govern all aspects of labor relations and designate a general employment contract with which all employees and employers must comply. This general employment contract adopts by reference the provisions of the Labor Law which principally relates to matters such as paid annual vacation, paid sick days, the length of the workday, payment for overtime and severance pay. Brazilian law generally requires severance pay equal to 50% of the sum the dismissed worker accumulated in its pension fund during the period of employment upon the retirement or death of an employee or termination of employment without cause. Brazilian employers are also required to purchase health insurance for employees, cover employees' food and travel costs, and allocate sums to the employees' pension fund. Furthermore, Brazilian employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Our payments to the National Insurance Institute amount 54 to 34.5% to 37.8% of the wages paid, depending on the amount of the wages, of which the employee contributes 7.7% to 11% and we contribute a fixed amount equal to 26.8%.



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All of our employees in Brazil, excluding the chief executive officer, the directors (VPs) and several managers, are members of a labor union and the employee member fees to the union are paid by us.

### Argentina

Our employees in Argentina are subject to Argentine labor laws and regulations and other special practices and employment customs. The laws and regulations in Argentina control all aspects of labor relations and designate a general Employment Contract with which all employees and employers must comply. This general Employment Contract adopts by reference the provisions of the Labor Law which principally concerns matters such as paid annual vacation, paid sick days, the length of the workday, and payment for overtime and severance pay. Argentinean law generally requires severance pay equal to one month per year of service upon the termination of employment without a justified cause. Argentine employers are also required to contribute for health insurance for employees and allocate sums to the employee's pension fund. Our payments for pension funds is 17.5% and healthcare amount to 6% of each gross salary.

Our employees in Argentina, excluding the chief executive officer and a number of other employees, are members of a labor union and the employee member fees are paid by them.

### United States

We have no collective bargaining agreements with any of our employees in the United States and none of our employees are members of a union.

### E. SHARE OWNERSHIP

The following sets forth, as of June 2008 the share ownership of our directors and executive officers. All of the information with respect to beneficial ownership by our directors and executive officers has been furnished by the respective director or executive officer, as the case may be.

| Name of Director/Officer(1) | Number of Ordinary Shares Beneficially Owned (2) | Percentage of beneficial ownership |
|-----------------------------|--|------------------------------------|
| Izzy Sheratzky(3)           | 5,809,579  | 24.75%                             |
| Professor Yehuda Kahane (4) | 2,128,539  | 9.07%                              |
| Zeev Koren                  |  |                                    |
| Avner Kurz (5)              | 1,447,925  | 6.17%                              |
| Amos Kurz (6)               | 1,445,205  | 6.16%                              |
| Yigal Shani (7)             | 368,211  | 1.57%                              |
| Eyal Sheratzky              |  |                                    |
| Nir Sheratzky               |  |                                    |
| Gil Sheratzky               |  |                                    |
| Yoav Kahane                 | *  | *                                  |
| Orna Ophir                  |  |                                    |
| Israel Baron                |  |                                    |
| Eli Kamer                   |  |                                    |
| Guy Aharonov                | *  | *                                  |

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\* owns less than one per cent of our outstanding share capital.

(1) This table includes only current directors and officers that beneficially hold our shares.

(2) Percentages in this column are based on 23,475,431 ordinary shares outstanding as of June, 2008. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission (as defined in Rule 13d-3 under the

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Securities Exchange Act of 1934) and shares deemed beneficially owned by virtue of the right of any person or group to acquire such ordinary shares within 60 days are treated as outstanding only for the purposes of determining the percent owned by such person or group. To our knowledge, the persons and entities named in the table above are believed to have sole voting and investment power with respect to all ordinary shares shown as owned by them, except as described below.

- (3) Shares beneficially owned include: (a) 302,627 shares directly owned by Mr. Sheratzky, of which 5,427 shares are jointly owned with his wife, Maddie; (b) 5,506,952 shares owned by Moked Ituran Ltd., which Mr. Sheratzky beneficially owns due to his shared voting and investment power over such shares in accordance with a certain shareholders agreement, dated May 18, 1998, among Moked Ituran and its shareholders, which we refer to as the Moked Shareholders Agreement. For further information concerning the Moked Shareholders Agreement see the discussion under Item 6.B. Compensation under the caption Shareholders agreement and articles of association of Moked Ituran above.
- (4) Shares beneficially owned include: (a) 547,782 shares directly owned by Professor Kahane, of which 429,576 shares are jointly owned with his wife, Rivka Kahane, (b) 148,950 shares owned by Yehuda Kahane Ltd., which Professor Kahane may be considered to beneficially own by virtue of his shared voting and investment control of the company through his 50% shareholdings thereof, the other 50% being owned by his wife, Rivka Kahane; and (c) 1,431,807 shares owned by Moked Ituran, which Professor Kahane may be considered to beneficially own by virtue of his right to direct the disposition of such shares in accordance with Moked's articles of association. Professor Kahane has shared voting and investment control over Yehuda Kahane Ltd., a holder of 26% of the shares of Moked Ituran.
- (5) Shares beneficially owned include: (a) 2,720 shares directly owned by Avner Kurz, (b) 13,398 shares owned by F.K. Generators and Equipment, which Avner Kurz may be considered to beneficially own by virtue of his shared voting and investment power over such shares through his 50% ownership of Perfect Quality Trading Ltd., a majority shareholder of F.K. with the other 50% ownership of Perfect Quality Trading Ltd. owned by Mr. Amos Kurz (Avner Kurz's brother), and (c) 1,431,807 shares owned by Moked Ituran that Avner Kurz may be considered to beneficially own through F.K. as described above, which F.K. is deemed to beneficially own by virtue of its right to direct the disposition of such shares in accordance with Moked's articles of association (due to its 26% ownership of Moked Ituran).
- (6) Shares beneficially owned include: (a) 13,398 shares owned by F.K. Generators and Equipment, which Amos Kurz may be considered to beneficially own by virtue of his shared voting and investment power over such shares through his 50% ownership of Perfect Quality Trading Ltd., a majority shareholder of F.K., with the other 50% ownership of Perfect Quality Trading Ltd. owned by Mr. Avner Kurz (Amos Kurz's brother); (b) 1,431,807 shares owned by Moked Ituran that Amos Kurz may be considered to beneficially own as described above.
- (7) Shares beneficially owned include: (a) 34,500 shares directly owned by Yigal Shani, (b) 127,200 shares owned by Tzivtit Insurance Agency (1998) Ltd., which Yigal Shani may be considered to beneficially own by virtue of his shared voting and investment control over such shares through his 50% ownership thereof, the other 50% of the shares held by Efraim Sheratzky, and (c) 206,511 shares owned by Moked Ituran, which Mr. Shani may be considered to beneficially own by virtue of his right to direct the disposition of such shares in accordance with Moked's articles of association. Mr. Shani may be considered to beneficially own such shares by virtue of his sole voting and investment control over G.N.S. Holdings, the holder of 3.75% of Moked's shares, in which he owns 100% of the shares.

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### Employee Share Option Plans

We adopted two option plans for managers and employees. The first option plan was adopted immediately prior to the time of our initial public offering on the Tel Aviv Stock Exchange in May 1998, pursuant to which we issued to our employees options to purchase 360,546 shares at a per-share exercise price of NIS 0.33<sup>1</sup>/<sub>3</sub>, or \$0.07, the par value of our ordinary shares. All options granted under the 1998 plan are fully vested and were exercised. Pursuant to our 2001 option plan, which was adopted on August 23, 2001, options to purchase an aggregate of 244,875 of our ordinary shares were granted to our employees, one of whom was also a director. All of these options were granted at a per-share exercise price of NIS 0.33<sup>1</sup>/<sub>3</sub>, or \$0.07. The closing price of our ordinary shares on the TASE on the date these options were granted was NIS 12.20, or \$2.67 per share. All of the options granted under the 2001 plan are fully vested and were exercised. In addition, on August 23, 2001, our Board of Directors resolved to grant options to purchase an aggregate of 601,857 ordinary shares to some of our directors and officers as follows: options to purchase 461,784 ordinary shares were granted to Mr. Izzy Sheratzky, our Chairman of the Board of Directors, options to purchase 50,796 ordinary shares were granted to each of Eyal Sheratzky and Nir Sheratzky, our Co-Chief Executive Officers and options to purchase 38,481 ordinary shares were granted to Mr. Yoav Kahane, our director. All such options were granted at a per-share exercise price of NIS 0.33<sup>1</sup>/<sub>3</sub> or \$0.07 and are all fully vested and exercisable. Of these additional options, 217,809 ordinary shares were issued pursuant to exercise of options by Yoav Kahane, Izzy Sheratzky, Eyal Sheratzky and Nir Sheratzky and options for the purchase of 50,796 ordinary shares held by Eyal Sheratzky and Nir Sheratzky expired. On July 18, 2005, a special meeting of our shareholders approved the issuance of fully vested options to Eyal Sheratzky and Nir Sheratzky, in place of those options that expired. These options are exercisable for one year at a per-share exercise price of NIS 0.33<sup>1</sup>/<sub>3</sub> or \$0.07, and were exercised in full by them in May 2006. In addition in 2007 Mr. Izzy Sheratzky, our Chairman of

the Board of Directors, exercised options to purchase 153,924 ordinary shares. As of the date of this report, there are no options which are fully vested and have not been exercised.

In January 2006, our remuneration committee adopted a resolution to pay our managers (not including managers who also serve as our directors) a quarterly bonus as of the first quarter of 2006 equal to 1.5% of our consolidated profit before tax and after equity and minority profits, which is divided between 13 of our managers in different proportions based on their seniority, level of global and domestic involvement in our operations and other criteria set by the committee.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### A. MAJOR SHAREHOLDERS

The following table shows the number of our ordinary shares beneficially owned by (a) the only shareholders known to us as of June, 2008, to beneficially own more than 5% of our outstanding ordinary shares and (b) all of our directors and executive officers as a group. The number of ordinary shares used in calculating the percentage for each person listed below includes the shares underlying options or warrants held by such person that are exercisable within 60 days.

The shareholders listed below do not have any different or special voting rights from any other shareholders of our company. Except where otherwise indicated, we believe, based on information furnished by the owners, that the beneficial owners of the ordinary shares listed below have sole investment and voting power with respect to such shares. To our knowledge, none of our shareholders of record are US Holders, other than Yoav Kahane.

| Shareholder                                     | Number of<br>Ordinary Shares<br>Beneficially<br>Owned (1) | Percentage of<br>Outstanding<br>Ordinary Shares<br>(1) |
|---|---|--|
| Moked Ituran Ltd. (1)                           | 5,506,952   | 23.69%   |
| F.K. Generators and Equipment Ltd. (2)          | 1,445,205   | 6.22%  |
| All directors and executive officers as a group | 7,961,255   | 29.65%   |
| The Baupost Group, L.L.C.(3)                    | 1,220,569   | 5.23%  |

(1) Moked's articles of association provides that each of Moked's shareholders shall have the right to direct Moked to dispose of such number of our shares corresponding to his or her relative shareholdings in Moked. For further information please see Item 6.B. Compensation under the caption Shareholders Agreement and Articles of Association of Moked Ituran above.

(2) Shares beneficially owned include 1,445,205 shares, of which (a) 13,398 shares are directly owned by F.K Generators & Equipment Ltd. (whereby Messrs. Avner Kurz and Amos Kurz are deemed to beneficially own said 13,398 shares owned by F.K. by virtue of their shared voting and investment power over such shares through their respective holdings of 50% each of ownership of Perfect Quality Trading Ltd., a majority shareholder of F.K.); and (b) 1,431,807 shares are owned by Moked Ituran Ltd., which F.K is deemed to beneficially own by virtue of its right to direct the disposition of such shares in accordance with a shareholders agreement dated May 28, 1998, as amended on September 6, 2005 (due to F.K.'s 26% ownership of Moked Ituran).

(3) the information presented herein is based on Form 13G filed by The Baupost Group, L.L.C. on March 5, 2008.

None of our major shareholders have different voting rights than each other and/or than our other shareholders.

As of June 30, 2008, we had a total of 2 shareholders of record in the United States with registered with addresses in the United States. The number of record holders in the United States is not representative of the number of beneficial holders nor is it representative of where such beneficial holders are resident since many of these ordinary shares were held of record by brokers or other nominees

\* Includes the Depository Trust Company.

**B. RELATED PARTY TRANSACTIONS**

*Transactions with our directors and principal officers*

We purchase our insurance policies, including our directors' and officers' insurance, through Tzivtit Insurance Agency (1998) Ltd., an insurance agency owned by Efraim Sheratzky, the brother of the Chairman of our Board of Directors and the uncle of both of our Co-Chief Executive Officers, and Yigal Shani, one of our directors. We pay an annual aggregate amount of NIS 924,000, or \$225,000, for our basic insurance policies and NIS 1,051,000, or \$256,000, for our directors' and officers' insurance policy. Tzivtit Insurance Agency is entitled to commissions in an aggregate amount of NIS 169,000, or \$41,000 to be paid by the insurance company on account of these policies.

We have entered into indemnification agreements with each of our directors and officers and the officers and directors of our subsidiaries providing them with indemnification for liabilities or expenses incurred as a result of acts performed by them in their capacity as our directors and officers.

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In February 2003, we entered into a two-year services agreement with A. Sheratzky Holdings, a company controlled by Izzy Sheratzky, and Izzy Sheratzky pursuant to which Mr. Sheratzky agreed to (i) cease to act as our Chief Executive Officer and (ii) to act as an independent contractor that provides us full-time services as Chairman of the Board of Directors, under the same terms of his previous employment as Chief Executive Officer. Pursuant to the agreement, A. Sheratzky Holdings will receive compensation equal to NIS 85,500, or approximately \$20,800, per month, adjusted for inflation, plus reimbursement of certain business expenses. In addition, Mr. Sheratzky will be entitled to participate in our profits in an amount equal to 5% of profits before tax, on a consolidated basis, based on our audited consolidated financial statements for the relevant year. This services agreement is automatically renewable for successive two-year periods until either party notifies the other of its intention to terminate the agreement, by providing a 180-day prior written notice.

On September 5, 2002, we entered into independent contractor agreements with A. Sheratzky Holdings and each of Eyal Sheratzky and Nir Sheratzky pursuant to which A. Sheratzky Holdings will provide management services to us through Eyal Sheratzky and Nir Sheratzky in consideration of monthly payments in the amount of NIS 48,892 and NIS 49,307, or \$11,900 and \$12,000, respectively, in addition to providing each of them a company car and reimbursement of certain business expenses. In January 2004, a change in the employment terms of the Chief Executive Officer was approved providing each of our Co-Chief Executive Officers, Eyal Sheratzky and Nir Sheratzky, an annual bonus in an amount equal to 1.0% of our profits before taxes, on a consolidated basis, based on our audited consolidated financial statements for the year for which the bonus is paid.

The aggregate amounts paid to A. Sheratzky Holdings in 2005, 2006 and 2007 were approximately \$1,480,000, \$2,581,000 and \$2,855,000, respectively (all numbers include value added tax).

On March 23, 1998, we entered into a financial services agreement with our director, Professor Kahane. Pursuant to this agreement, we are obligated to pay Professor Kahane a monthly consulting fee of NIS 4,000, or approximately \$900, linked to the Israeli consumer price index. The initial term of the agreement was two years, automatically renewable for additional two-year terms, until terminated by either party by providing a 180-day prior notice. In May 2003, the monthly fee payable to Professor Kahane under the agreement was increased to NIS 15,000, or approximately \$3,370, linked to the consumer price index. The aggregate amounts paid to Professor Kahane in each of the years 2005 and 2006 was approximately \$47,000 and \$50,800 in 2007 (all numbers include value added tax).

On January 23, 2007, our subsidiary, E-Com Global Electronic Commerce Ltd. with Gil Sheratzky for the employment of Mr. Sheratzky as CEO of that Company in consideration of monthly payments in the amount of NIS 25,000 or \$5,610, in addition to providing him a company car, managers insurance and education fund contribution (as customary in Israel) and reimbursement of certain business expenses. In this position, Mr. Sheratzky will report to our CEO. The compensation paid to Gil Sheratzky includes a bonus in an amount equal to 2% of the annual increase in that company's profits before tax, (up to a maximum amount of 1% of that company's profits before tax) based on its audited consolidated financial statements for the relevant year, beginning January 1, 2007.

*Transactions with our affiliates and associates*

In December 31, 2007, we closed a transaction pursuant to which our subsidiary, Telematics Wireless was sold to a third party. As a result of such sale transaction, the Company entered into a 10 year supply and production agreement with Telematics for the supply of products and services by Telematics to the Company. Furthermore, the Company and Telematics entered into a Revenue Sharing Agreement in respect of future revenues of Telematics. For further descriptions of the sale transaction, the 10 year supply and production agreement and the revenue sharing agreement, please refer to Item 4.A. History and Development of our Company.

**C. INTERESTS OF EXPERTS AND COUNSEL**

Not applicable

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**ITEM 8 FINANCIAL INFORMATION****A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION**

For the audited financial statements and audit reports required to be contained in this annual report, please see Item 18 below.

*Legal proceedings*

We are involved in litigation with Leonardo L.P., a US-based hedge fund, arising out of a financial transaction entered into between us and Leonardo in February 2000. Pursuant to the terms of this financial transaction, we received a cash investment of \$12 million in exchange for certain notes that were convertible into our ordinary shares according to a pre-determined formula. Pursuant to the formula, the conversion price of the notes was the lower of NIS 67.3 (\$14.7) or an average trading price of our shares for a defined period prior to conversion. The conversion price is used to determine the number of shares into which the notes may be converted by dividing the notional principal amount of the notes, initially \$12 million, by the conversion price. On the date the notes were issued, March 2, 2000, the notes were convertible into approximately 720,000 of our ordinary shares. As part of the terms of this financial transaction, and, as required by the rules of the TASE where our ordinary shares are currently traded, we were required to seek the approval from the TASE for the issuance of the ordinary shares underlying the notes. The TASE approved the issuance of 2,250,000 of our ordinary shares as the number of registered shares that could be issued under the notes. We understood the terms of our financial transaction with Leonardo to provide that, except in certain limited circumstances, the amounts advanced to us, together with accrued interest on these advances at the annual rate of 3.5%, would be repaid and satisfied solely through the delivery of ordinary shares and that under no circumstance would we be required to deliver more than 2,250,000 of our ordinary shares. We believe that Leonardo also recognized that there was a limit on the number of shares issuable under the notes, and in fact at no time on or prior to the maturity date of the notes did Leonardo seek to convert the notes for more than 2,250,000 of our ordinary shares. Prior to the maturity date of the notes, Leonardo converted approximately \$6.7 million of the notional principal amount of the notes into an aggregate of 2,241,594 of our ordinary shares. We believe that the holders of the notes are therefore only entitled to convert the balance of their notes into 8,406 shares, although in the pending litigation Leonardo has indicated that it does not believe that the notes were subject to any limit on the number of shares that could be issued to them on conversion and is seeking to recover damages based on this allegation.

The terms of the documents and agreements that comprise the financial arrangement with Leonardo contain provisions regarding the repayment and conversion of the notes which may be regarded as conflicting or subject to different interpretations. Accordingly, we believe that the matter may only be resolved through a litigation in which the parties present evidence as to the proper meaning and operation of the repayment and conversion provisions of documents and agreements comprising the financing transaction with Leonardo. The parties are currently in early stages of pleading the case before a district court in Israel and are in the process of undertaking discovery. In its pleadings, Leonardo is seeking alternative remedies and relief, including (a) the repayment in cash of the balance of the notes in the amount of approximately \$6.2 million (plus accrued interest and expenses), (b) the delivery to Leonardo of the maximum number of our ordinary shares into which the notes could have been converted on the maturity date without regard to the 2,250,000 share limitation, or 3,516,462 ordinary shares, plus additional monetary damages, or (c) the payment of a cash amount equal to the amount obtained by multiplying the 3,516,462 shares mentioned in the preceding clause by the highest trading price of our ordinary shares between the maturity date and the date of the court's decision, plus interest or expenses. Although there can be no assurances as to the final outcome of this litigation, we believe that the maximum liability that we could have in this matter, assuming that a court rejects our interpretation of the agreements or determines that we have otherwise defaulted in the notes, is approximately \$9.6 million. In addition, in June, 2006, Leonardo was initially permitted to amend its claim to add an additional cause of action, claiming that on January 29, 2002 we also breached the same agreement because Moked Ituran Ltd. distributed some of our shares to other parties, in violation of the covenant that entitles Leonardo the option to redeem the notes Moked Ituran to maintain at least 70% of the number of our shares that it held at the time we entered into the financial transaction with Leonardo. Based on such alleged breach, Leonardo is seeking an additional alternative remedy of \$9.6 million, plus interest and expenses. We successfully appealed the decision allowing Leonardo to amend its claim on legal grounds and such permission was ultimately revoked by the court. Leonardo subsequently filed a request for leave to appeal such decision to the Israeli Supreme Court, which request was denied. Leonardo further requested two more times, and on separate occasions, to amend its claim with relation to the same said alleged breach. Leonardo's request was denied twice by the district court, and Leonardo requested the Supreme Court once again for leave to appeal the decisions. Leonardo's second request for leave to appeal the last decisions has not yet been decided. While we cannot predict the outcome of this case, if Leonardo prevails, the award to Leonardo of damages, either in cash or by delivery of our ordinary shares, could result in significant costs to us, adversely affecting our results of operations. In addition, the issuance of our ordinary shares to Leonardo may impact the share price of our ordinary shares and would dilute our shareholders

ownership percentage.

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On July 8, 2005, a class action was filed against our subsidiary, Ituran Florida Corporation, in the First Judicial District Court in Philadelphia, Pennsylvania. The lawsuit claims that Ituran Florida sent fax advertisements to the named plaintiff and the other members of the class allegedly in violation of the Telephone Consumer Protection Act of 1991. Ituran Florida filed a motion for judgment on the pleadings that such claims should not be heard as part of a class action. Such motion was denied by the court and the case is currently at the interrogatories and requests for production of information stage. The plaintiff agreed to limit the class action to Pennsylvania actions only and the maximum potential amount of damages that we estimate our subsidiary may be liable for pursuant to the provisions of the Telephone Consumer Protection Act if the plaintiffs prevail is approximately \$1.5 million in the aggregate for all class plaintiffs, plus punitive damages and expenses. We do not believe that the plaintiffs will prevail and, even if they do prevail, we do not believe that the resolution of this claim will have a material effect on our revenues, operations or liquidity.

#### *Dividend distribution policy*

On January 29, 2004, we adopted a dividend policy providing for an annual dividend distribution in an amount equal to 25% of our net profits, calculated based on the financial statements for the period ending on December 31 of the fiscal year with respect to which the relevant dividend is paid.

According to our current dividend policy and Israeli law, an annual dividend will only be declared and paid if, in the discretion of the Board of Directors, there is no reasonable foreseeable concern that the distribution will prevent us from being able to meet the terms of our existing and contingent liabilities, as and when due. Our dividend policy may change from time to time at the discretion of our Board of Directors. Due to the foregoing restrictions on our dividend policy, and given our current financial condition and our current cash flows from operations, we do not believe that our dividend policy restricts our growth.

Dividends declared on our ordinary shares will be paid in NIS. Dividends paid to shareholders outside of Israel will be converted into dollars on the basis of the exchange rate prevailing on the date of the declaration of the relevant dividend and paid in dollars. The payment of dividends may be subject to Israeli withholding taxes. See Item 10.E. Taxation under the caption Israeli taxation withholding on dividends paid to non-residents of Israel below.

On January 29, 2004, upon adopting our current dividend policy, we declared a dividend in an amount equal to NIS 6.0 million, or \$1.3 million. Such dividend was paid on April 1, 2004. On March 23, 2005, we declared a dividend in an amount equal to NIS 11.8 million, or \$2.7 million. Such dividend was paid on April 28, 2005. On February 20, 2006, we declared a dividend in the amount equal to NIS 17.6 million, or \$3.8 million. Such dividend was paid on April 4, 2006. On February 20, 2007, we declared a dividend in the amount equal to NIS 20.1 million, or \$4.8 million. Such dividend was paid on April 4, 2007. On February 21, 2008, we declared a dividend in the amount equal to NIS 108 million, or \$30 million. Such dividend was paid on April 8, 2008. We did not declare or pay any cash dividends to shareholders during the five-year period prior to January 29, 2004.

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## **B. SIGNIFICANT CHANGES**

Except for as stated in this annual report, there are no significant financial changes as of December 31, 2007.

## **ITEM 9. THE OFFER AND LISTING**

### **A. OFFER AND LISTING DETAILS**

#### **Price History of Our Shares**

Our ordinary shares have been trading on the Tel-Aviv Stock Exchange under the symbol ITRN since May 1998 and have been trading on the Nasdaq National Market under the symbol ITRN since September 2005.

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The following table sets forth, for the periods indicated, the high and low market prices of our ordinary shares as reported by the Nasdaq National Market. Our shares commenced trading on the Nasdaq National Market on September 27, 2005. All per share prices for periods prior to or including May 2007 have been retroactively adjusted to reflect the three for one stock split effected on that date.

|  | <u>High</u> | <u>Low</u> |
|--|-------------|------------|
| <b>During the last six months</b>                  |             |            |
| May 2008   | \$ 13.62    | \$ 10.99   |
| April 2008   | \$ 11.80    | \$ 10.19   |
| March 2008   | \$ 11.27    | \$ 10.00   |
| February 2008                                      | \$ 11.81    | \$ 10.74   |
| January 2008                                       | \$ 11.79    | \$ 10.03   |
| December 2007                                      | \$ 11.07    | \$ 10.00   |
| <b>During each fiscal quarter of 2007 and 2008</b> |             |            |
| First Quarter 2008                                 | \$ 11.81    | \$ 10.00   |
| Fourth Quarter 2007                                | \$ 12.20    | \$ 9.93    |
| Third Quarter 2007                                 | \$ 13.60    | \$ 11.32   |
| Second Quarter 2007                                | \$ 15.14    | \$ 12.47   |
| First Quarter 2007                                 | \$ 15.72    | \$ 13.32   |

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The following table shows, for the periods indicated, the high and low market prices of our ordinary shares as quoted on the Tel-Aviv Stock Exchange. U.S. dollars per ordinary share amounts are calculated using the applicable rate of exchange on the date the high or low market price occurred during the period shown. All per share prices prior to or including September 2005 have been retroactively adjusted to reflect the three-for-one stock split effected on that date.

|                                | <u>Price per<br/>ordinary share (NIS)</u> |            | <u>Price per<br/>ordinary share (\$)</u> |            |
|--------------------------------|---|------------|--|------------|
|                                | <u>High</u>                               | <u>Low</u> | <u>High</u>                              | <u>Low</u> |
| <b>Annual:</b>                 |   |            |  |            |
| 2007                           | 66.41                                     | 37.97      | 15.72                                    | 9.82       |
| 2006                           | 85.29                                     | 60.62      | 18.53                                    | 13.86      |
| 2005                           | 75.37                                     | 40.97      | 16.80                                    | 9.13       |
| 2004                           | 41.57                                     | 25.42      | 9.78                                     | 5.60       |
| 2003                           | 26.37                                     | 8.23       | 6.07                                     | 1.69       |
| <b>Quarterly:</b>              |   |            |  |            |
| Fourth Quarter 2007            | 48.15                                     | 37.97      | 12.03                                    | 9.82       |
| Third Quarter 2007             | 57.57                                     | 46.00      | 13.64                                    | 11.07      |
| Second Quarter 2007            | 60.11                                     | 52.73      | 15.29                                    | 12.47      |
| First Quarter 2007             | 66.41                                     | 55.44      | 15.72                                    | 13.29      |
| Fourth Quarter 2006            | 76.49                                     | 61.36      | 17.83                                    | 14.29      |
| Third Quarter 2006             | 67.41                                     | 60.62      | 15.32                                    | 13.86      |
| Second Quarter 2006            | 78.71                                     | 61.75      | 17.11                                    | 13.78      |
| First Quarter 2006             | 85.29                                     | 73.03      | 18.53                                    | 15.87      |
| Fourth Quarter 2005            | 75.37                                     | 53.97      | 16.23                                    | 11.62      |
| Third Quarter 2005             | 62.70                                     | 43.07      | 13.64                                    | 9.66       |
| Second Quarter 2005            | 52.30                                     | 43.07      | 11.96                                    | 9.66       |
| First Quarter 2005             | 52.47                                     | 40.97      | 12.14                                    | 9.32       |
| <b>Most recent six months:</b> |   |            |  |            |
| May 2008                       | 43.29                                     | 37.04      | 13.17                                    | 10.82      |

## Edgar Filing: Ituran Location & Control Ltd. - Form 20-F

|               |       |       |       |       |
|---------------|-------|-------|-------|-------|
| April 2008    | 40.85 | 36.31 | 11.83 | 10.15 |
| March 2008    | 40.32 | 34.06 | 11.51 | 10.08 |
| February 2008 | 43.50 | 39.86 | 12.10 | 11.02 |
| January 2008  | 43.54 | 36.77 | 11.32 | 9.91  |
| December 2007 | 43.40 | 38.85 | 11.28 | 10.02 |

### **B. PLAN OF DISTRIBUTION**

Not applicable

### **C. MARKETS**

Our ordinary shares are quoted only on the Nasdaq National Market and the Tel-Aviv Stock Exchange under the symbol ITRN .

### **D. SELLING SHAREHOLDERS**

Not applicable

### **E. DILUTION**

Not applicable

### **F. EXPENSES OF THE ISSUE**

Not applicable

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## **ITEM 10. ADDITIONAL INFORMATION**

### **A. SHARE CAPITAL**

Not applicable

### **B. MEMORANDUM AND ARTICLES OF ASSOCIATION**

Our number with the Israeli Registrar of Companies is 52-004381-1. Our purpose appears in our memorandum of association and includes engaging in any lawful business.

#### *Articles of Association; Israeli Companies Law*

#### **Articles of Association**

Pursuant to our articles of association our objectives are to engage in any lawful business and our purpose is to operate in accordance with business considerations to maximize our profits. We may take into consideration, inter alia, the interests of our creditors, employee and the public interest. Please also see a summarized description of our purposes and activities under the caption Overview in Item 4.A. above.

#### **Our Corporate Practices Under The Israeli Companies Law**

##### *Approval of Transactions under Israeli Law*

#### **Directors and executive officers**

##### *Fiduciary duties*

Israeli law codifies the fiduciary duties that directors and executive officers owe to a company. These fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care requires a director or executive officer to act with the level of care with which a reasonable director or executive officer in the same position would have acted under the same circumstances. The duty of loyalty requires that a director or



executive officer act in good faith and in the best interests of the company.

*Personal interest*

Israeli law requires that a director or executive officer promptly disclose to the board of directors any personal interest that he or she may have and all related material information known to him or her concerning any existing or proposed transaction with the company. A personal interest includes an interest in any company in which the person, his or her relative or any entity in which such person or relative has a personal interest, is a direct or indirect 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. Board approval is required for the transaction and no transaction that is adverse to the company's interest may be approved. Approval by the company's audit committee and board of directors is required for an extraordinary transaction, meaning any transaction that is not in the ordinary course of business, not on market terms or is likely to have a substantial effect on the company's profitability, assets or liabilities. If a majority of the board of directors has a personal interest in the transaction, shareholder approval is also required.

*Compensation arrangements*

Pursuant to the Israeli Companies Law, all compensation arrangements for executive officers who are not directors require approval of our board of directors. Extraordinary transactions with executive officers who are not directors require additional approvals. Compensation arrangements with directors require the approval of our audit committee, board of directors and shareholders, in that order. Transactions relating to exculpation, insurance or indemnification of (a) executive officers require audit committee approval and subsequent board of directors approval and (b) directors require audit committee approval, board of directors approval and subsequent shareholder approval.

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**Shareholders**

*Controlling shareholders*

Pursuant to Israeli law, the disclosure requirements regarding personal interests that apply to directors and executive officers also apply to a controlling shareholder of a public company. A controlling shareholder is a shareholder who has the ability to direct the activities of a company, including a shareholder who owns 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights. Currently Moked Ituran Ltd. is considered a controlling shareholder of our company under Israeli law and we expect it will continue to be a controlling shareholder following the consummation of this offering. Mr. Izzy Sheratzy beneficially owns the shareholdings of Moked Ituran due to his shared voting and investment power over such shares in accordance with a shareholders agreement, dated May 18, 1998, among Moked Ituran and its shareholders, as amended. In addition, all shareholders of Moked Ituran who are parties to such shareholders agreement, may also be considered controlling shareholders under Israeli law.

*Required approval*

Extraordinary transactions with a controlling shareholder, or in which a controlling shareholder has a personal interest, including a private placement in which a controlling shareholder has a personal interest, and the terms of compensation or employment of a controlling shareholder or his or her relative who is a director, executive officer or employee, require the approval of the audit committee, the board of directors and the shareholders, in that order. This shareholder approval must include the majority of shares voted at the meeting. In addition, either:

- § the majority must include at least one-third of the shares of disinterested shareholders voted at the meeting; or
- § the total number of shares of disinterested shareholders who voted against the transaction must not exceed 1.0% of the aggregate voting rights in the company.

The approval of the board of directors and shareholders is required for a private placement of securities (or a series of related private placements during a 12-month period or that are part of one continuous transaction or transactions conditioned upon each other) that:

- § represents at least 20% of a company's actual voting power prior to the issuance of such securities, and that would increase the relative holdings of a 5% shareholder or that would cause any person to become a 5% shareholder the consideration for which (or a portion thereof) is not cash or securities listed on a recognized stock exchange, or is not at fair market value; or
- § results in a person becoming a controlling shareholder of the company.

For these purposes, a controlling shareholder is any shareholder that has the ability to direct actions of the company, including any shareholder holding 25% or more of the company's voting rights if no other shareholder owns more than 50% of such voting rights. Two or more shareholders with a personal interest in the approval of the same transaction are deemed to be one shareholder.

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*Shareholder duties*

Pursuant to the Israeli Companies Law, a shareholder has a duty to act in good faith and in customary way toward the company and other shareholders and to refrain from abusing his or her power in the company, including, among other things, in voting at the general meeting of shareholders and class meetings with respect to the following matters:

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

In addition, specified shareholders have a duty of fairness toward the company. These shareholders include any controlling shareholder, any shareholder who knows that it possesses the power to determine the outcome of a shareholder vote and any shareholder who has the power to appoint or to prevent the appointment of an office holder of the company or other power towards the company. The Israeli Companies Law does not define the substance of this duty of fairness.

***Anti take-over provisions; mergers and acquisitions under Israeli Law***

**Tender offer**

A person wishing to acquire shares or any class of shares of a publicly traded Israeli company and who would, as a result, hold over 90% of the company's issued and outstanding share capital or of a class of shares that are listed, is required by the Israeli Companies Law to make a tender offer to all of the company's shareholders or all shareholders of such class of shares, as applicable, for the purchase of all of the issued and outstanding shares of the company or of that class of shares, as applicable. If the shareholders who do not respond to the offer hold less than 5% of the issued share capital of the company or of that class of shares, as applicable, all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. However, the shareholders may petition the court to alter the consideration for the acquisition. If the dissenting shareholders hold more than 5% of the issued and outstanding share capital of the company or of such class of shares, as applicable, the acquirer may not acquire additional shares of the company or of such class of shares, as applicable, from shareholders who accepted the tender offer if following such acquisition the acquirer would then own over 90% of the company's issued and outstanding share capital or of the shares comprising such class, as applicable.

The Israeli Companies Law provides that an acquisition of shares of a public company must be made by means of a tender offer if as a result of the acquisition the purchaser would become a holder of 25% or more of the voting rights of the company. This rule does not apply if there is already another holder of 25% or more of the voting rights of the company. Similarly, the Israeli 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 holder of more than 45% of the voting rights of the company, if there is no other holder of more than 45% of the voting rights of the company.

The foregoing provisions do not apply to:

- § a private placement in which the company's shareholders approved such holder owning 25% or more of the voting rights of the company (provided that there is no other shareholder that holds 25% or more of the voting rights of the company); or more than 45% of the voting rights of the company (provided that there is no other shareholder that holds 45% or more of the voting rights of the company); or
- § a purchase from an existing holder of 25% or more of the voting rights of the company that results in another person becoming a holder of 25% or more of the voting rights of the company or purchase from an existing holder of more than 45% of the voting rights of the company that results in another person becoming a holder of more than 45% of the voting rights of the company.

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## Merger

The Israeli Companies Law permits merger transactions if approved by each party's board of directors and shareholders. Pursuant to the Israeli Companies Law and our articles of association as currently in effect, merger transactions may be approved by holders of a simple majority of our shares present, in person or by proxy, at a general meeting and voting on the transaction. In determining whether the required majority has approved the merger in the event of cross ownership between the merging companies, namely, if our shares are held by the other party to the merger, or by any person holding at least 25% of the outstanding voting shares or 25% of the means of appointing directors of the other party to the merger, then a vote against the merger by holders of the majority of the shares present and voting, excluding shares held by the other party or by such person, or anyone acting on behalf of either of them, including any of their affiliates, is sufficient to reject the merger transaction. If the transaction would have been approved but for the exclusion of the votes of certain shareholders as provided above, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of a company, if the court holds that the merger is fair and reasonable, taking into account the value of the parties to the merger and the consideration offered to the shareholders. Upon the request of a creditor of either party to the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger. In addition, a merger may not be consummated unless at least 50 days have passed from the time that a proposal for approval of the merger has been filed with the Israeli Registrar of Companies and 30 days have passed from the date of the approval of the shareholders of the merging companies.

The Israeli Companies Law further provides that the foregoing approval requirements will not apply to shareholders of a wholly-owned subsidiary in a roll-up merger transaction, or to the shareholders of the acquirer if:

- § the transaction is not accompanied by an amendment to the acquirer's memorandum or articles of association;
- § the transaction does not contemplate the issuance of more than 20% of the voting rights of the acquirer that would result in any shareholder becoming a controlling shareholder; and
- § there is no cross-ownership of shares of the merging companies, as described above.

For these purposes, controlling shareholder is a shareholder who has the ability to direct the activities of a company, including a shareholder who owns 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights.

The Israeli Companies Law allows us to create and issue shares having rights different from those attached to our ordinary shares, including shares providing certain preferred or additional rights to voting, distributions or other matters and shares having preemptive rights. In the future, if we do create and issue a class of shares other than our ordinary shares, such class of shares, depending on the specific rights that may be attached to them, may delay or prevent a takeover or otherwise prevent our shareholders from realizing a potential premium over the market value of their ordinary shares. The authorization of a new class of shares will require an amendment to our articles of association. Shareholders voting at such a meeting will be subject to the restrictions under the Israeli Companies Law. See "Voting rights" above.

*Dividend and Liquidation Rights.* We may declare a dividend to be paid to the holders of our ordinary shares according to their rights and interests in our profits. If we dissolve, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of our ordinary shares in proportion to their shareholdings. 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. Our articles of association provide that shareholder approval would not be required for the declaration of dividends. Dividends may only be paid out of our retained earnings or profits accrued over a period of two years, as defined in the Israeli Companies Law, whichever is greater, according to the last reviewed or audited financial reports of the company, provided that the date of the financial reports is not more than six months before the date of distribution, and further provided that there is no reasonable concern that a payment of a dividend will prevent us from satisfying our existing and foreseeable obligations as they become due, as determined by our Board of Directors.

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*Voting, Shareholder Meetings and Resolutions.* As a foreign private issuer, we have elected to follow our home country practices in lieu of the Nasdaq Marketplace Rule requiring an issuer to hold its annual meeting of its shareholders no later than one year after the end of the issuer's fiscal year-end. Specifically, according to Israeli law, we are required to hold an annual general meeting of our shareholders once every calendar year, but no later than 15 months after the date of the previous annual general meeting. All meetings other than the annual general meeting of shareholders are referred to as special meetings. Our Board of Directors may call special meetings whenever it sees fit, at such time and place, within or outside of Israel, as it may determine. In addition, the Israeli Companies Law provides that the board of directors of a public company

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is required to convene a special meeting upon the request of (a) any two directors of the company or one quarter of its board of directors or (b) one or more shareholders holding, in the aggregate, (i) 5% of the outstanding shares of the company and 1% of the voting power in the company or (ii) 5% of the voting power in the company.

Pursuant to our articles of association, shareholders are entitled to participate and vote at general meetings and are the shareholders of record on a date to be decided by our Board of Directors, provided that such date is not more than 21 days, nor less than four days, prior to the date of the general meeting, except as otherwise permitted by the Israeli Companies Law. Furthermore, the Israeli Companies Law dictates that resolutions regarding the following matters must be passed at a general meeting of our shareholders:

- § amendments to our articles of association;
- § appointment or termination of our auditors;
- § appointment and dismissal of external directors;
- § approval of acts and transactions requiring general meeting approval pursuant to the Israeli Companies Law;
- § increase or reduction of our authorized share capital;
- § a merger; and
- § the exercise of the Board of Directors powers by a general meeting, if the Board of Directors is unable to exercise its powers and the exercise of any of its powers is required for our proper management.

The Israeli Companies Law and our articles of association require that a notice of any annual or special shareholders meeting will be provided 21 days prior to the meeting.

Pursuant to our articles of association, holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of the shareholders. These 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 we may authorize in the future. The quorum required for our ordinary meetings of shareholders consists of at least two shareholders present in person or by proxy, who hold or represent between them at least one-third of the total outstanding voting rights. 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 on a later date specified in the summons or notice of the meeting. At the reconvened meeting, any number of our shareholders present in person or by proxy shall constitute a lawful quorum.

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Our articles of association provide that, other than with respect to the amendment of the provisions of the articles of association with respect to the appointment of directors and a resolution for removal of a director, which action requires a majority vote of 75%, all resolutions of the shareholders require a simple majority.

Israeli law does not provide for public companies such as ours to have shareholder resolutions adopted by means of a written consent in lieu of a shareholders meeting. The Israeli Companies Law provides that a shareholder, in exercising his or her rights and performing his or her obligations toward the company and its other shareholders, must act in good faith and in an acceptable manner and avoid abusing his or her powers. This is required, among other things, when voting at general meetings on matters such as changes to the articles of association, increasing the company's registered capital, mergers and approval of related-party transactions. In addition, pursuant to the Israeli Companies Law, any controlling shareholder, any shareholder who knows that its vote can determine the outcome of a shareholder vote and any shareholder who, under the company's articles of association, can appoint or prevent the appointment of an office holder, is required to act with fairness towards the company. The Israeli Companies Law does not describe the substance of this duty and there is no binding case law that addresses this subject directly. Pursuant to Israeli Law, no voting agreement may circumvent these shareholder duties.

An ordinary resolution requires approval by the holders of a simple majority of the voting rights represented at the meeting, in person, by proxy or by written ballot, and voting on the resolution. Under the Israeli Companies Law, unless otherwise provided in the articles of association or applicable law, all resolutions of the shareholders require a simple majority. A resolution for the voluntary winding up of the company requires the approval of holders of 75% of the voting rights represented at the meeting, in person, by proxy or by written ballot and voting on the resolution. For information regarding the majority required for approval of related party transactions, see Approval of related party transactions under Israeli law above.

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Transfer of Shares and Notice. Our ordinary shares that are fully paid are issued in registered form and may be freely transferred under our articles of association unless the transfer is restricted or prohibited by applicable law.

Election of Directors. Our ordinary shares do not have cumulative voting rights in the election of directors. As a result, the holders of a majority of the voting power represented at a shareholders meeting have the power to elect all of our directors, subject to the special approval requirements for external directors described under the caption External directors in Item 6.C. Board Practices above. Pursuant to the Israeli Companies Law, the procedures for the appointment and removal and the term of office of directors, other than external directors, may be contained in the articles of association of a company. Our articles of association provide for staggered terms for directors. This provision may be amended only by a vote of 75% of our shares voting at a meeting of shareholders.

Insurance, Indemnification and Release. Pursuant to the Israeli Companies Law, an Israeli company may not exculpate a director or officer from liability for a breach of his or her duty of loyalty. A company may, however, approve an act performed in breach of the duty of loyalty provided that the director or officer acted in good faith, neither the act nor its approval harms the company, and the director or officer discloses the nature of his or her personal interest and all material facts and documents a reasonable time before discussion of the approval. A company may exculpate a director or officer in advance from liability to the company for a breach of his or her duty of care, but only if a provision authorizing such exculpation is included in its articles of association and such breach does not relate to a dividend or other distribution by the company. Our articles of association do not include such a provision. A company may indemnify a director or officer in respect of certain liabilities either in advance of an event or following an event provided that a provision authorizing such indemnification is inserted in its articles of association. Our articles of association contain such a provision. An undertaking by a company to indemnify a director or officer for civil actions by third parties must be limited to foreseeable liabilities and reasonable amounts or criteria determined by the board of directors. A company may insure a director or officer against the following liabilities incurred for acts performed as a director or officer:

- § a breach of duty of care to the company or to a third party;
- § a breach of duty of loyalty to the company, provided the director or officer acted in good faith and had a reasonable basis to believe that the act would not prejudice the interests of the company; and
- § monetary liabilities imposed for the benefit of a third party.

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We have acquired directors and officers liability insurance covering our officers and directors and the officers and directors of our subsidiaries against certain claims. To date, no claims for liability have been filed under this policy. In addition, we have entered into indemnification agreements with each of our directors and officers and the officers and directors of our subsidiaries providing them with indemnification for liabilities or expenses incurred as a result of acts performed by them in their capacity as our directors and officers.

Change in Capital. Our articles of association enable us to increase or reduce our share capital. Any such changes are subject to the provisions of the Israeli Companies Law and must be approved by a resolution duly passed by our shareholders at a general meeting and voting on such change in the capital. In addition, transactions that have the effect of reducing capital, such as the declaration and payment of dividends in the absence of sufficient retained earnings and profits and an issuance of shares for less than their nominal value, require a resolution of the Board of Directors and court approval.

### C. MATERIAL CONTRACTS

#### The Teletrac Agreements

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

The technology licensed to us by Teletrac, which we refer to as the Teletrac intellectual property, is licensed to us by virtue of a series of agreements pursuant to which we have secured the exclusive rights to use the Teletrac intellectual property in Israel, Brazil, Argentina, and certain cities in the United States. We have also secured certain exclusive rights to use the Teletrac intellectual property in other designated countries and non-exclusive rights to use the Teletrac intellectual property in every country outside of the United States and Europe.

We are not required to pay any ongoing royalties for use of the Teletrac intellectual property in Israel, although we may be required in the future to pay a royalty up to 3% of sales of products and services utilizing the Teletrac intellectual property in countries where we wish to maintain our exclusive rights. We also have the right to use the Teletrac intellectual property in any country outside of Europe and the United States on a non-exclusive basis upon payment to Teletrac of a fee of \$100,000 for each country in which the Teletrac intellectual property is so used or sold. Our license agreements with Teletrac are perpetual in term unless terminated by mutual agreement or for breach, including bankruptcy, dissolution or insolvency.

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## The Mapa Agreement

In 2007, we purchased the entire issued share capital of Mapa Group from its shareholders for approx. US\$9.9 million. In addition, we invested an additional sum of approx. US\$3.1 million to the Mapa Group, which was used by Mapa Group to repay shareholders' loans to its shareholders. Following the closing of the transaction, we are the holders of 100% of the issued share capital of the Mapa Group. The Mapa Group is the leading and largest provider of geographic information (GIS) in Israel and owner of geographic information database for navigation in Israel, GISrael. The Mapa acquisition represents a major step in strengthening our position in the field of location based services in Israel, by leveraging the best platform available. Mapa is uniquely positioned as the main provider of the geographic information database for navigation in Israel. These unique capabilities will not only serve us as a location based service provider, but will also allow us to sell the rights for using the database to other location based service providers, including the cellular operators who see this as one of the fastest growing areas. On June 30, 2007 we obtained the approval of the Israeli Commissioner for Trade Practices for the Mapa acquisition. The approval was conditioned on the following terms to be fulfilled by Ituran (whose conditions do not detract from the provisions of the Restrictive Practices Act, 1988): (a) Mapa Group should not unreasonably refrain from selling its computerized geographic information (GIS) products (the Products) and any updates to any customer; (b) Mapa Group shall not act discriminatively in similar transactions for customers interested in purchasing Mapa Group's Products; (c) Mapa Group shall not link or condition the supply of its Products to a sale of service and/or other product.

For a description of an agreement for the sale of our subsidiary, Telematics, including ancillary agreements related to revenue sharing and frame product and services purchase agreement between Ituran and Telematics please refer to Item 4.A. History and Development of our Company under the caption *Our History* above.

### D. EXCHANGE CONTROLS

Under current Israeli regulations, any dividends or other distributions paid in respect of our ordinary shares purchased by nonresidents of Israel with certain non-Israeli currencies (including dollars) and any amounts payable upon the dissolution, liquidation or winding up of our affairs, as well as the proceeds of any sale in Israel of our securities to an Israeli resident, may be paid in non-Israeli currencies (including US dollars) or, if paid in NIS, may be converted into freely repatriable currencies at the rate of exchange prevailing at the time of conversion pursuant to the general permit issued under the Israeli Currency Control Law, 1978, provided that Israeli income tax has been paid on (or withheld from) such payments. Because exchange rates between the NIS and the U.S. dollar fluctuate continuously, U.S. shareholders will be subject to any such currency fluctuation during the period from when such dividend is declared through the date payment is made in U.S. dollars. Investments outside Israel by the Company no longer require specific approval from the Controller of Foreign Currency at the Bank of Israel.

### E. TAXATION

The following describes certain income tax issues relating to us and also certain income tax consequences arising from the purchase, ownership and disposition of our ordinary shares. **This discussion is for general information only and is not intended, and should not be construed, as legal or professional tax advice and does not cover all possible tax considerations.** To the extent that the discussion is based on legislation yet to be judicially or administratively interpreted, there can be no assurance that the views expressed herein will accord with any such interpretation in the future. Accordingly, holders of our ordinary shares should consult their own tax advisor as to the particular tax consequences arising from your purchase, ownership and disposition of ordinary shares, including the effects of applicable Israeli, United States and other laws and possible changes in the tax laws.

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The following discussion represents a summary of the material United States & Israeli tax laws affecting us and our shareholders.

### United States Tax Considerations

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The following discussion is a description of the material United States, or US, federal income tax considerations applicable to the acquisition, ownership and disposition of our ordinary shares by US Holders who acquire their shares pursuant to this offering and who hold such ordinary shares as capital assets. As used in this section, the term US Holder means a beneficial owner of an ordinary share who is:

- § a citizen or resident of the United States;
- § a corporation or partnership created or organized in or under the laws of the United States or of any state of the United States or the District of Columbia (other than a partnership that is not treated as a US person under any applicable Treasury regulations);
- § an estate, the income of which is subject to United States federal income taxation regardless of its source; or
- § a trust if the trust has elected validly to be treated as a US person for United States federal income tax purposes or if a US court is able to exercise primary supervision over the trust's administration and one or more US persons have the authority to control all of the trust's substantial decisions.

The term Non-US Holder means a beneficial owner of an ordinary share who is not a US Holder. The tax consequences to a Non-US Holder may differ substantially from the tax consequences to a US Holder. This discussion does not address any aspects of US federal income tax which may be relevant to a Non-US Holder. Accordingly, Non-US Holders are strongly urged to consult with their own tax advisors.

This description is based on provisions of the United States Internal Revenue Code of 1986, as amended, which we refer to as the Code, existing, proposed and temporary US Treasury regulations and administrative and judicial interpretations thereof, each as available and in effect as of the date of this report. These sources may change, possibly with retroactive effect, and are open to differing interpretations. This description does not discuss all aspects of US federal income taxation that may be applicable to investors in light of their particular circumstances or to investors who are subject to special treatment under US federal income tax law, including:

- § insurance companies;
- § dealers or traders in stocks, securities or currencies;
- § financial institutions and financial services entities;
- § real estate investment trusts;
- § regulated investment companies;
- § grantor trusts;
- § persons that receive ordinary shares as compensation for the performance of services;
- § tax-exempt organizations;
- § persons that hold ordinary shares as a position in a straddle or as part of a hedging, conversion or other integrated instrument;
- § individual retirement and other tax-deferred accounts;
- § expatriates of the United States;
- § persons having a functional currency that is not the dollar; or
- § direct, indirect or constructive owners of 10% or more, by voting power or value, of our ordinary shares.

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This description also does not consider the US federal gift or estate tax or alternative minimum tax consequences of the acquisition, ownership and disposition of our ordinary shares.

If a partnership (or any other entity treated as a partnership for US federal income tax purposes) holds our ordinary shares, the tax treatment of a partner in such partnership will generally depend on the status of the partner and the activities of the partnership. Such a partner should consult its tax advisor as to its tax consequences.

**We urge our shareholders to consult with your own tax advisor regarding the tax consequences of acquiring, owning or disposing of our ordinary shares, including the effects of US federal, state, local and foreign and other tax laws. This summary does not constitute, and should not be construed as, legal or tax advice to holders of our shares.**

### Distribution Paid on the Ordinary Shares

On January 29, 2004, we adopted a dividend policy providing for an annual dividend distribution in an amount equal to 25% of our net profits, which is calculated based on the financial statements for the period ending on December 31 of the fiscal year for which the dividend is paid.

Subject to the discussion below under *Passive Foreign Investment Company Considerations*, US Holders, for US federal income tax purposes, will generally be required to include in their gross income as ordinary dividend income the amount of any distributions made to them in cash or property (other than certain distributions, if any, of our ordinary shares distributed pro rata to all our shareholders), with respect to their ordinary shares, before reduction for any Israeli taxes withheld (without regard to whether any portion of such tax may be refunded to them by the Israeli tax authorities), to the extent that those distributions are paid out of our current or accumulated earnings and profits as determined for US federal income tax purposes. Subject to the discussion below under *Passive Foreign Investment Company Considerations*, distributions in excess of our current and accumulated earnings and profits as determined under US federal income tax principles will be applied first against, and will reduce their tax basis in, your ordinary shares and, to the extent they exceed that tax basis, will then be treated as capital gain. We do not maintain calculations of our earnings and profits under US federal income tax principles. Our dividends will not qualify for the dividends-received deduction generally available to corporate US Holders.

For shareholders who are qualified as US Holder, if we pay a dividend in NIS, any such dividend, including the amount of any Israeli taxes withheld, will be includible in such US Holders' income in a US dollar amount calculated by reference to the currency exchange rate in effect on the day the distribution is includible in your income, regardless of whether the NIS are converted into dollars. Any gain or loss resulting from currency exchange fluctuations during the period from the date the dividend is includible in such US Holders' income to the date that payment is converted into dollars generally will be treated as ordinary income or loss.

A non-corporate US Holder's qualified dividend income currently is subject to tax at reduced rates not exceeding 15%. This reduced rate applicable to qualified dividend income does not apply to tax years beginning after December 31, 2008. For purposes of determining whether US Holders will have qualified dividend income, qualified dividend income generally includes dividends paid by a foreign corporation if either:

- § the stock of that corporation with respect to which the dividends are paid is readily tradable on an established securities market in the US, or
- § that corporation is eligible for benefits of a comprehensive income tax treaty with the US that includes an information exchange program and is determined to be satisfactory by the US Secretary of the Treasury. The Internal Revenue Service has determined that the US-Israel Tax Treaty is satisfactory for this purpose.

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In addition, under current law, a shareholder of our shares who is a US Holder, must generally hold his ordinary shares for more than 60 days during the 120-day period beginning 60 days prior to the ex-dividend date in order for the dividend to qualify as qualified dividend income.

Dividends paid by a foreign corporation will not be treated as qualified dividend income, however, if such corporation is treated, for the tax year in which the dividend is paid or the preceding tax year, as a passive foreign investment company for US federal income tax purposes. We do not believe that we will be classified as a passive foreign investment company for US federal income tax purposes for our current taxable year. However, see the discussion under *Passive foreign investment company considerations* below.

### Foreign Tax Credit

If a holder of our shares is a US Holder, any dividends paid by us to such shareholder with respect to our ordinary shares generally will be treated as foreign source passive income for US foreign tax credit purposes. Subject to the foreign tax credit limitations, if a holder of our shares is a US Holder such holder may elect to credit any Israeli income taxes withheld from dividends paid on our ordinary shares against such shareholder's US federal income tax liability (provided, *inter alia*, such shareholder satisfies certain holding requirements with respect to our ordinary shares). Amounts withheld in excess of the Treaty tax rate, however, will not be creditable against such shareholder's US federal income tax liability. As an alternative to claiming a foreign tax credit, such shareholder may instead claim a deduction for any withheld Israeli income taxes, but only for a year in which such shareholder elects to do so with respect to all foreign income taxes. The amount of foreign income taxes that may be claimed as a credit in any year is subject to complex limitations and restrictions, which must be determined on an individual basis by



each shareholder. Accordingly, our shareholders should consult their own tax advisor to determine whether their income with respect to their ordinary shares would be foreign source income and whether and to what extent they would be entitled to the credit.

### Disposition of Ordinary Shares

Upon the sale or other disposition of ordinary shares, subject to the discussion below under **Passive foreign investment company considerations**, if a holder of our shares is a US Holder, such shareholder generally will recognize capital gain or loss equal to the difference between the amount realized on the disposition and such shareholder's adjusted tax basis in the ordinary shares, which is usually the cost of such shares, in dollars. US Holders should consult their own advisors with respect to the tax consequences of the receipt of a currency other than dollars upon such sale or other disposition.

Gain or loss upon the disposition of the ordinary shares will be treated as long-term if, at the time of the disposition, the ordinary shares were held for more than one year. Long-term capital gains realized by non-corporate US Holders generally are subject to a lower maximum marginal US federal income tax rate than the maximum marginal US federal income tax rate applicable to ordinary income, other than qualified dividend income, as defined above. The deductibility of capital losses by a US Holder is subject to limitations. In general, any gain or loss recognized by a US Holder on the sale or other disposition of ordinary shares will be US source income or loss for US foreign tax credit purposes. US Holders should consult their own tax advisors concerning the source of income for US foreign tax credit purposes and the effect of the US-Israel Tax Treaty on the source of income.

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### Passive Foreign Investment Company Considerations

Special US federal income tax rules apply to US Holders owning shares of a **passive foreign investment company**, or a PFIC, for US federal income tax purposes. A non-US corporation will be considered a PFIC for any taxable year in which, after applying look-through rules, either

- § 75% or more of its gross income consists of specified types of passive income, or
- § 50% or more of the average value of its assets consists of passive assets, which generally means assets that generate, or are held for the production of, passive income.
- § Passive income for this purpose generally includes dividends, interest, royalties, rents and gains from commodities and securities transactions and includes amounts derived by reason of the temporary investment of funds. If we were classified as a PFIC, and you are a US Holder, you could be subject to increased tax liability upon the sale or other disposition of ordinary shares or upon the receipt of amounts treated as **excess distributions** (generally, your ratable portion of distributions in any year which are greater than 125% of the average annual distribution received by you either in the shorter of the three preceding years or your holding period). Under these rules, the excess distribution and any gain would be allocated ratably over our shareholders' holding period for the ordinary shares, and the amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we were a PFIC would be taxed as ordinary income. The amount allocated to each of the other taxable years would be subject to tax at the highest marginal rate in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed on the resulting tax allocated to such other taxable years. In addition, holders of stock in a PFIC may not receive a **step-up** in basis on shares acquired from a decedent. If any of our shareholders are US Holders who hold ordinary shares during a period when we are a PFIC, such shareholders be subject to the foregoing rules even if we cease to be a PFIC.

We believe that we will not be classified as a PFIC for US federal income tax purposes for our current taxable year and we anticipate that we will not become a PFIC in any future taxable year based on our financial statements, our current expectations regarding the value and nature of our assets, and the sources and nature of our income. This conclusion, however, is a factual determination that must be made annually based on income and assets for the entire taxable year and thus may be subject to change. It is not possible to determine whether we will be a PFIC for the current taxable year until after the close of the year and our status in future years depends on our income, assets and activities in those years. In addition, because the market price of our ordinary shares is likely to fluctuate after this offering and the market price of the shares of technology companies has been especially volatile, and because that market price may affect the determination of whether we will be considered a PFIC, we cannot assure that we will not be considered a PFIC for any taxable year.

If we were a PFIC, our shareholders could avoid certain tax consequences referred to above by making an election to treat us as a qualified electing fund or by electing to mark the ordinary shares to market. A US Holder may make a qualified electing fund election only if we furnish the US Holder with certain tax information and we do not presently intend to prepare or provide this information. Alternatively, a US Holder of PFIC stock that is publicly traded may elect to mark the stock to market annually and recognize as ordinary income or loss each year an amount

equal to the difference as of the close of the taxable year between the fair market value of the PFIC stock and the US Holder's adjusted tax basis in the PFIC stock. Losses would be allowed only to the extent of net mark-to-market gain previously included by the US Holder under the election for prior taxable years. This election is available for as long as our ordinary shares constitute marketable stock, which includes stock that is regularly traded on a qualified exchange or other market. We believe that the Nasdaq National Market will constitute a qualified exchange or other market for this purpose. However, no assurances can be provided that our ordinary shares will continue to trade on the Nasdaq National Market or that the shares will be regularly traded for this purpose.

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The rules applicable to owning shares of a PFIC are complex, and our shareholders should consult with their own tax advisor regarding the tax consequences that would arise if we were treated as a PFIC.

### **Information Reporting and Back-up Withholding**

Dividend payments with respect to ordinary shares and proceeds from the sale or disposition of ordinary shares made within the United States or by a US payor or US middleman may be subject to information reporting to the Internal Revenue Service and possible US backup withholding at a current rate of 28%. Certain exempt recipients (such as corporations) are not subject to these information reporting requirements. Backup withholding also will not apply to a US Holder who furnishes a correct taxpayer identification number and makes any other required certification or otherwise is exempt from US backup withholding requirements. US Holders who are required to establish their exempt status must provide such certification on Internal Revenue Service Form W-9. US Holders should consult their tax advisors regarding the application of the US information reporting and backup withholding rules.

Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules may be credited against a US Holder's US federal income tax liability and a US Holder may obtain a refund of any excess amounts withheld by filing the appropriate claim for refund with the Internal Revenue Service and furnishing any required information in a timely manner.

**The above description is not intended to constitute a complete analysis of all tax consequences relating to acquisition, ownership and disposition of our ordinary shares. Our shareholders are urged to consult their own tax advisor concerning the tax consequences of their particular situation.**

### **Israeli Tax Considerations**

The following is a summary of the current material Israeli tax laws applicable to companies in Israel with special reference to its effect on us. This section also contains a discussion of certain Israeli government programs from which we may benefit and some Israeli tax consequences to persons acquiring ordinary shares in this offering. This summary does not discuss all the acts of Israeli tax law that may be relevant to a particular investor in light of his or her personal investment circumstances or to some types of investors subject to special treatment under Israeli law. Examples of this kind of investor include residents of Israel, traders in securities or persons that own, directly or indirectly, 5% or more of our outstanding capital, all of whom are subject to special tax regimes not covered in this discussion. Some parts of this discussion are based on new tax legislation that has not been subject to judicial or administrative interpretation. Accordingly, we cannot assure you that the views expressed in the discussion will be accepted by the tax authorities in question. The discussion is not intended and should not be construed as legal or professional tax advice and does not cover all possible tax considerations.

Potential investors are urged to consult their own tax advisors as to the Israeli or other tax consequences of the purchase, ownership and disposition of our ordinary shares, including, in particular, the effect of any foreign, state or local taxes.

### **General Corporate Tax Structure in Israel**

The regular corporate tax rate in Israel was 29% in 2007 compared to 31% in 2006 and 34% in 2005. This rate is currently scheduled to decrease as follows: in 2008 27%, 2009 26% and 2010 and onward 25%.

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### **Special Provisions Relating to Taxation Under Inflationary Conditions**

The Income Tax Law (Inflationary Adjustments), 1985, generally referred to as the Inflationary Adjustments Law, represents an attempt to overcome the problems presented to a traditional tax system by an economy undergoing rapid inflation. The Inflationary Adjustments Law is

highly complex. The provisions that are material to us, are summarized as follows:

- § Where a company's equity, as calculated under the Inflationary Adjustments Law, exceeds the depreciated cost of its fixed assets (as defined in the Inflationary Adjustments Law), a deduction from taxable income is permitted equal to the above excess multiplied by the applicable annual rate of inflation. The maximum deduction permitted in any single tax year is 70% of taxable income, with the unused portion permitted to be carried forward, linked to the Israeli consumer price index.
- § Where a company's depreciated cost of fixed assets exceeds its equity, then the excess multiplied by the applicable annual rate of inflation is added to taxable income.
- § Subject to specified limitations, depreciation deductions on fixed assets and losses carried forward are adjusted for inflation based on the change in the consumer price index.

Under the Inflationary Adjustments Law, results for tax purposes are measured in real terms, in accordance with changes in the Israeli consumer price index. We are taxed under this law. The difference between the change in the Israeli consumer price index and the exchange rate of Israeli currency in relation to the dollar may in future periods cause significant differences between taxable income and the income measured in dollars as reflected in our consolidated financial statements.

### Capital Gains Tax Applicable to Resident and Non-Resident Shareholders

Israeli law generally imposes a capital gains tax on the sale of capital assets located in Israel, including shares in Israeli resident companies, by both residents and non-residents of Israel, unless a specific exemption is available or unless a treaty between Israel and the country of the non-resident provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain that is equivalent to the increase of the relevant asset's purchase price which is attributable to the increase in the Israeli consumer price index or, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

Generally, up until the 2006 tax year, capital gains tax was imposed on Israeli resident individuals at a rate of 15% on real gains derived on or after January 1, 2003 from the sale of shares in, among others, (i) Israeli companies publicly traded on a recognized stock market in a country that has a treaty for the prevention of double taxation with Israel (such as Nasdaq), or (ii) companies dually traded on both the TASE and Nasdaq or another recognized stock market outside of Israel (such as Ituran). This tax rate was contingent upon the shareholder not claiming a deduction for financing expenses in connection with such shares (in which case the gain was generally taxed at a rate of 25%), and did not apply to: (1) dealers in securities; (2) shareholders that report in accordance with the Adjustments Law; or (3) shareholders who acquired their shares prior to an initial public offering; or (4) the sale of shares to a relative (as defined in the Tax Ordinance).

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

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The tax basis of shares acquired prior to January 1, 2003 will be determined in accordance with the higher of the average closing share price in the three trading days preceding January 1, 2003, and cost.

Non-Israeli residents are exempt from Israeli capital gains tax on any gains derived from the sale of shares publicly traded on the TASE, provided such gains did not derive from a permanent establishment of such shareholders in Israel, and are exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock market outside of Israel (including Nasdaq), provided however that such shareholders did not acquire their shares prior to an initial public offering, that such capital gains are not derived from a permanent establishment in Israel, and that such shareholders are not subject to the Adjustments Law. However, non-Israeli corporations will not be entitled to such exemption if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli corporation, or (ii) is the beneficiary or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

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

### **Taxation of Non-Resident Shareholders**

Non-residents of Israel are subject to Israeli income tax on income accrued or derived from sources in Israel, including passive income such as dividends, royalties and interest. On distributions of dividends, other than bonus shares and stock dividends, income tax is withheld at the source at the following rates: (i) for dividends distributed prior to January 1, 2006 25%; (ii) for dividends distributed on or after January 1, 2006 20%, or 25% for a shareholder that is considered a Material Shareholder at any time during the 12-month period preceding such distribution; unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. As aforesaid, dividends of income generated by an Approved Enterprise are subject to withholding tax at a rate of 15%.

Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of shares who is a treaty U.S. resident is 25% or 15% if the dividends are generated by an Approved Enterprise (or Benefited Enterprise). Such tax rate is reduced to 12.5% for dividends not generated by an Approved Enterprise (or Benefited Enterprise) if the non-resident is a U.S. corporation and holds 10% or more of our voting power during the part of the tax year that precedes the date of payment of the dividend and during the whole of its prior tax year, and provided that not more than 25% of the Israeli company's gross income consists of interest or dividends.

### **F. DIVIDENDS AND PAYING AGENTS**

Not Applicable

### **G. STATEMENT BY EXPERTS**

Not Applicable

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### **H. DOCUMENTS ON DISPLAY**

We are required to file reports and other information with the Securities and Exchange Commission under the Securities Exchange Act of 1934 and the regulations thereunder applicable to foreign private issuers. Reports and other information filed by us with the Securities and Exchange Commission may be inspected and copied at the Securities and Exchange Commission's public reference facilities described below. We are not required to file periodic information as frequently or as promptly as United States companies. As a foreign private issuer, we are also exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements; and our officers, directors and principal shareholders are exempt from the reporting and other provisions of Section 16 of the Exchange Act.

You may review a copy of our filings with the Securities and Exchange Commission, including any exhibits and schedules, at the Securities and Exchange Commission's public reference facilities at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may also obtain copies of such materials at prescribed rates by writing to the Public Reference Section of the Securities and Exchange Commission at 100 F Street, N.E., Washington, D.C. 20549. You may call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the public reference rooms. As a foreign private issuer we are now required to file through the Securities and Exchange Commission's EDGAR system and our periodic filings are therefore available on the Securities and Exchange Commission's Web site. You may read and copy any reports, statements or other information that we file with the Securities and Exchange Commission at the Securities and Exchange Commission facilities listed above. These Securities and Exchange Commission filings are also available to the public from commercial document retrieval services.

We also files annual and special reports and other information with the Israeli Securities Authority through its fair disclosure electronic system called the MAGNA. You may review these filings on the website of the MAGNA system operated by the Israeli Securities Authority at [www.magna.isa.gov.il](http://www.magna.isa.gov.il) or on the website of the TASE at [www.tase.co.il](http://www.tase.co.il).

**I. SUBSIDIARY INFORMATION**

Not Applicable

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The principal market risks to which we are exposed as a result of our operations are foreign exchange rate risks and interest rate risks.

**Foreign exchange rate risk**

Although we report our consolidated financial statements in dollars, in 2005, 2006 and 2007, a portion of our revenues and expenses was derived in other currencies. For fiscal years 2005, 2006 and 2007, we derived approximately 48.9%, 53.2% and 47.3% of our revenues in dollars, 20.4%, 14.3% and 19.8% in NIS, 23.3%, 24.8% and 25.3% in Brazilian Reals and 7.4%, 7.6% and 7.6% in Argentine Pesos, respectively. In fiscal years 2005, 2006 and 2007, 44.2%, 42.9% and 35.7% of our expenses were incurred in dollars, 35.2%, 31% and 35.5% in NIS, 15.5%, 21.5% and 23.2% in Brazilian Reals and 5.1%, 4.6% and 5.6% in Argentine Pesos, respectively.

Exchange differences upon conversion from our functional currency to dollars are accumulated as a separate component of accumulated other comprehensive income under shareholders' equity. In the year 2007, accumulated other comprehensive income increased by \$10.7 million compared to the year 2006. In the year 2006, accumulated other comprehensive income decreased by \$6.4 million compared to the year 2005. In the year 2005, accumulated other comprehensive income increased by \$0.9 million compared to the year 2004. In 2004, accumulated other comprehensive income decreased by \$0.2 million compared to the year 2003. Exchange differences upon conversion from the functional currency from our other selling and marketing subsidiaries to dollars are reflected in our income statements under financing expenses, net.

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The fluctuation of the other currencies in which we incur our expenses or generate revenues against the NIS or the dollar has had the effect of increasing or decreasing (as applicable) reported revenues, cost of revenues and operating expenses in such foreign currencies when converted into dollars from period to period. The following table illustrates the effect of the changes in exchange rates on our revenues, gross profit and operating income for the periods indicated:

|                  | Year Ended December 31, |                                       |           |                                       |            |                                       |            |                                       |
|------------------|-------------------------|---------------------------------------|-----------|---------------------------------------|------------|---------------------------------------|------------|---------------------------------------|
|                  | 2004                    |                                       | 2005      |                                       | 2006       |                                       | 2007       |                                       |
|                  | Actual                  | At 2003 exchange rates <sup>(1)</sup> | Actual    | At 2004 exchange rates <sup>(1)</sup> | Actual     | At 2005 exchange rates <sup>(1)</sup> | Actual     | At 2006 exchange rates <sup>(1)</sup> |
|                  | (In thousands)          |                                       |           |                                       |            |                                       |            |                                       |
| Revenues         | \$ 77,926               | \$ 77,263                             | \$ 90,126 | \$ 86,653                             | \$ 104,052 | \$ 101,605                            | \$ 124,838 | \$ 119,837                            |
| Gross profit     | 36,038                  | 35,895                                | 42,540    | 40,761                                | 50,199     | 49,037                                | 57,199     | 55,021                                |
| Operating income | 18,263                  | 18,370                                | 19,922    | 19,065                                | 24,732     | 24,406                                | 72,499     | 72,781                                |

(1) Based on average exchange rates during the period.

In the past, we entered into foreign currency forward contracts generally of 12 to 18 months' duration to hedge a portion of our foreign currency risk on the subscription fees payable in connection with our location-based services. The objective of these transactions is to hedge cash flow against fluctuations in the exchange rates of the dollar, NIS, Brazilian Real and Argentine Peso. All these contracts expired in September 2004. Our policy remains to reduce exposure to exchange rate fluctuations by entering into foreign currency forward transactions that qualify as hedging transactions under FAS No. 133, the results of which are reflected in our income statements as revenues. The result of these transactions, which are affected by fluctuations in exchange rates, could cause our revenues, gross profit and operating income to fluctuate.

**Interest rate risk**

We invest our cash balances primarily in bank deposits and therefore, we are exposed to market risks resulting from changes in general interest rates, primarily in the United States and Israel, but we do not believe such risks to be material. We do not use derivative financial instruments to limit exposure to interest rate risk.

**ITEM 12. DESCRIPTIONS OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not Applicable.

**PART II**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

Not applicable.

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

**A. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS**

Effective as of September 27, 2005, our shareholders adopted amended and restated articles of association. These amended and restated articles were primarily adopted in order to match the provisions of the new Israeli Companies Law. Therefore, most of the material modifications were prescribed by the changes in the companies law. In addition, the amended and restated articles of association provided for a staggered board of directors as more fully discussed in Item 6.C. Board Practices under the caption Board of Directors above. In 2007 additional amendments were made to our articles of association as requested by the Ministry of Communications and as described in Item 4.B Business Overview under the caption *Regulatory Environment* above.

**E. USE OF PROCEEDS**

The effective date of our first registration statement, filed on Form F-1 under the Securities Act of 1933 (No. 333-128028) relating to the initial public offering of our ordinary shares, was September 27, 2005. The offering was managed by UBS Securities LLC, JP Morgan Securities Inc., William Blair & Company, LLC and C.E. Unterberg, Towbin, LLC.

In the offering, we sold 4,256,000 ordinary shares for an aggregate offering price of \$55.3 million and the selling shareholders, sold 1,064,000 shares for an aggregate offering price of \$13.8 million.

The amount of the underwriting discount paid by us in the offering was \$3.6 million and the expenses of the offering, not including the underwriting discount, were approximately \$2.3 million.

**ITEM 15. CONTROLS AND PROCEDURES**

See Item 15T below.

**ITEM 15T. CONTROLS AND PROCEDURES**

(A) Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended) as of December 31, 2007, have concluded that, as of such date, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure and is recorded, processed, summarized and reported within the periods specified by the SEC's rules and forms.

(B) Management's Annual Report on Internal Control Over Financial Reporting

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Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Internal control over financial reporting is designed to provide reasonable assurance to our management and the board of directors regarding the reliability of financial reporting and the preparation and fair presentation of published financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurances with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may decline.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. In making this assessment, it used the criteria established in *Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. Based on such assessment, management has concluded that, as of December 31, 2007, the Company's internal control over financial reporting is not effective due to several material weaknesses.

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A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual financial statements will not be prevented or detected on a timely basis. Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2007, utilizing the criteria described above. The objective of this assessment was to determine whether the Company's internal control over financial reporting was effective as of December 31, 2007. Our assessment identified the following control deficiencies as of December 31, 2007, that constituted material weaknesses and exist only in the Company's subsidiary, Teleran Holdings Ltda. and its subsidiary Ituran Sistemas Monitoramento Ltda. ( **Ituran Brazil** ):

- § Ineffective controls related to reconciliation of Accounts receivables. This control deficiency has resulted in audit adjustments to the consolidated annual financial statements for the year ended December 31, 2007.
- § Ineffective controls to ensure timely and accurate recording of transfers of inventory to fixed assets, as well as products delivered to or returned from customers. Such deficiency, also affect the controls over physical inventories and provision for obsolescence which are not effectives. This control deficiency resulted in audit adjustments to the consolidated annual financial statements for the year ended December 31, 2007.
- § Ineffective controls related to the process of internal review of the financial statements of our subsidiary, Ituran Brazil and segregation of duties. There exist ineffective review procedures of the financial reports in Ituran Brazil, although such review is conducted on a consolidated basis. This control deficiency resulted in audit adjustments to the consolidated annual financial statements for the year ended December 31, 2007. This lack of segregation of duties is a deficiency in the design of our internal control over financial reporting that may allow for improprieties or errors in the application of accounting practices to go undetected. Although this ineffective control exists in Ituran Brazil, on a consolidated basis we do not view it as a material weakness as a review is conducted in Ituran.

Our management did not assess the effectiveness of our former subsidiary Telematics Wireless Ltd. internal control over financial reporting, which was sold on December 31, 2007, as further described Item 4.A. History and Development of the Company, under the caption *Our History* above.

### ***Change in Internal Control over Financial Reporting***

There have not been any changes in our internal control over financial reporting during the year ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### ***Remediation Steps to Address Material Weaknesses***

The Company's executive, regional and financial management are committed to achieving and maintaining a strong control environment and an overall tone within the organization. In addition, management remains committed to the process of developing and implementing improved corporate governance and compliance initiatives. Our current management team has been actively working on remediation efforts to address the material weaknesses, as well as other identified areas of risk as follows:

- § We have recruited additional personnel in the accounting department in Ituran Brazil in order to address the lack of segregation of duties in our prior structure. This new position will play a critical role in ensuring the integrity of financial information reported.

§ The Company is taking, or plan to take in the near future, the following additional actions:

- o Conducting reviews of accounting processes to incorporate technology improvements to strengthen the design and operation of controls;
- o Improving quality control reviews within the accounting function to ensure account analyses and reconciliations are completed accurately, timely, and with proper management review;
- o Formalizing and expanding the documentation of the Company's procedures for review and oversight of financial reporting.

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We believe the measures described above, once designed and operating effectively, will remediate the material weaknesses we have identified and strengthen our internal control over financial reporting. We are committed to continuing to improve our internal control processes and will diligently and vigorously review our financial reporting controls and procedures. As we continue to evaluate and work to improve our internal control over financial reporting, we may determine to take additional remediation measures or determine to modify, or in appropriate circumstances not to complete, certain of the remediation measures described above.

Management's assessment of the effectiveness of Ituran's internal control over financial reporting as of December 31, 2007 has been audited by Fahn Kanne & Co., an independent registered public accounting firm in Israel and a member of Grant Thornton International (Fahn Kanne), as stated in their report included below.

*(C) Attestation Report of the Registered Public Accounting Firm.*

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

### **TO THE SHAREHOLDERS OF**

### **ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

We have audited Ituran Location and Control Ltd. (the Company) and its subsidiaries internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying management's report on internal control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We did not audit internal control over financial reporting of Teleran Holding Ltda. (Teleran) and Ituran Argentina S.A. (Ituran Argentina), subsidiaries of the Company, whose financial statements reflect total assets and revenues constituting 18% and 33%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2007. Teleran and Ituran Argentina internal control over financial reporting were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to Teleran and Ituran Argentina internal control over financial reporting in relation to the Company taken as a whole, is based solely on the report of the other auditors.

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We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit and the report of other auditors provide a reasonable basis for our opinion.



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A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or combination of control deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management's assessment:

Ineffective controls related to reconciliation of Accounts Receivables. This control deficiency has resulted in audit adjustments to the consolidated annual financial statements for the year ended December 31, 2007.

Ineffective controls to ensure timely and accurate recording of transfers of inventory to fixed assets, as well as products delivered to or returned from customers. Such deficiency, also affect the controls over physical inventories and provision for obsolescence which are not effective. This control deficiency resulted in audit adjustments to the consolidated annual financial statements for the year ended December 31, 2007.

Ineffective controls related to the process of internal review of the financial statements of the Company's subsidiary, Teleran and segregation of duties. There exist ineffective review procedures of the financial reports in Teleran. This control deficiency resulted in audit adjustments to the consolidated annual financial statements for the year ended December 31, 2007. This lack of segregation of duties is a deficiency in the design of the Company's internal control over financial reporting that may allow for improprieties or errors in the application of accounting practices to remain undetected. As described in Management's report on internal control over financial reporting, although this ineffective control exists in Teleran, on a consolidated basis, the management of the Company does not view it as a material weakness as a review is conducted at the Company level.

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In our opinion, based on our audit and the report of other auditors, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company and its subsidiaries for the year ended December 31, 2007. The material weaknesses identified above were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 financial statements, and this report does not affect our report dated June 30, 2008, which expressed an unqualified opinion on those financial statements.

As described in Management's Report on internal control over financial reporting, management has excluded the former subsidiary Telematics Wireless Ltd. internal control over financial reporting, from its assessment of internal control over financial reporting as of December 31, 2007 because it was sold on December 31, 2007 as discussed in Note 1.A.1.d to the Company's consolidated financial statements for the year ended December 31, 2007. We have also excluded Telematics Wireless Ltd. from our audit of internal control over financial reporting. Telematics Wireless Ltd.'s total revenues represent approximately 16% of the related consolidated financial statement amounts for the year ended December 31, 2007.

Fahn Kanne & Co.  
Certified Public Accountants (Isr.)  
Tel-Aviv, Israel  
June 30, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM TO THE SHAREHOLDERS OF ITURAN

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Board of Directors and Shareholders

Ituran Argentina S.A.

Introductory Paragraph:

We have audited management's assessment, included in the accompanying (Management's Report on Internal Control), that Ituran Argentina S.A. maintained effective internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). The Ituran Argentina S.A. management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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Scope Paragraph:

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition Paragraph:

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Inherent Limitations Paragraph:

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion Paragraph:

In our opinion, management's assessment that Ituran Argentina S.A. maintained effective internal control over financial reporting as of December 31, 2007, is fairly stated, in all material respects, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). Also, in our opinion, Ituran Argentina S.A. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ).

Explanatory Paragraph:

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of Ituran Argentina S.A. as of December 31, 2007 and 2006, and the related statements of income stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2007, and our report dated February 8, 2008, expressed an unqualified opinion on those financial statements.

Signed by:

Gustavo R. Chesta (Partner)  
Mazars - Argentina  
February 8, 2008

**Audidores Independentes**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the shareholders of Teleran Holding Ltda. - Brazilian entity

We have audited Teleran Holding Ltda. Company's internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Teleran Holding Ltda. Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the management's report on internal control over Financial Reporting . Our responsibility is to express an opinion on W Company's internal control over financial reporting based on our audit.

We conducted our audits in accordance with the Brazilian generally accepted auditing standards, which are substantially equivalent to those established by the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment:

Ineffective controls related to reconciliation of the Accounts Receivables. This control deficiency has resulted in audit adjustments to the annual financial statements for the year ended December 31, 2007.

Ineffective controls to ensure timely and accurate recording of transfers of inventory to fixed assets, as well as goods are delivered to or returned from customers. Such deficiency, also effect the controls over physical inventories and provision for obsolescence which are not effectives. This control deficiency resulted in audit adjustments to the annual financial statements for the year ended December 31, 2007.

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Ineffective controls related to review of financial statements. The financial statements are prepared by local management and no review is performed. This control deficiency resulted in audit adjustments to the annual financial statements for the year ended December 31, 2007.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the balance sheet as of December 31, 2007, and the related statements of income, changes in shareholders' equity and cash flow as of and for the year ended December 31, 2007 of the Company, and this report does not affect our report on such financial statements.

In our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2007, based on the criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Sao Paulo, Brazil  
June 27, 2008

José André Viola Ferreira

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### ITEM 16. [RESERVED]

#### ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our board of directors determined that Mr. Israel Baron, one of our independent directors, is an audit committee financial expert, as defined by the applicable regulations promulgated under Section 407 of the Sarbanes-Oxley Act.

#### ITEM 16B. CODE OF ETHICS

In 2005, we adopted a Code of Ethics that applies to our senior management, including chief executive officer, chief financial officer, internal auditor and other individuals performing similar functions. This code of ethics has been posted on our website at [www.ituran.com](http://www.ituran.com).

#### ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Fahn Kanne & Co., a member firm of Grant Thornton International has served as our independent public accountants for each of the fiscal years ended in the three-year period ended December 31, 2007. The following table presents aggregate fees for professional audit services and other services rendered by Fahn Kanne & Co., for the year ended December 31:

|                    | 2007       | 2006              | 2005       |
|--------------------|------------|-------------------|------------|
|                    |            | (\$ in thousands) |            |
| Audit Fees         | 154        | 99                | 100        |
| Audit Related Fees |            | 5                 | 7          |
| Tax Fees           | 7          | 18                | 19         |
| All Other Fees     | 11         | 11                | 2          |
| <b>Total</b>       | <b>172</b> | <b>133</b>        | <b>128</b> |

The audit fees for the years ended December 31, 2007, 2006 and 2005, respectively, were for professional services rendered for the audits of our annual consolidated financial statements, review of consolidated quarterly financial statements, statutory audits of Ituran, and assistance with review of documents filed with the SEC.

Tax fees for the years ended December 31, 2007, 2006 and 2005, respectively, were for services related to tax compliance, including the preparation of tax returns and claims for refund; tax planning and tax advice, including assistance with tax audits.

Our audit committee has pre-approved certain audit and non-audit services provided by Fahn Kanne & Co. during the year 2007, up to a certain amount.

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

In reliance upon Nasdaq Marketplace Rule 4350(a)(1), as a foreign private issuer, we have elected to follow our home country practices, absent home country rules requiring otherwise, in lieu of certain Nasdaq Marketplace Rules. Specifically, in Israel, it is not required that a public company have (i) a majority of its board of directors be independent, as defined in Marketplace Rule 4350(c), (ii) an audit committee comprised solely of members who are able to read and understand fundamental financial statements as required by Nasdaq Marketplace Rule 4350(d)(2) or (iii) a nominating committee as required by Nasdaq Marketplace Rule 4350(c)(4). As a result, we have elected to follow Israeli law regarding independence requirements of our Board of Directors and the composition of our Board of Directors will remain as is. See External directors. Similarly, we have elected to follow Israeli law with regard to the composition of our existing audit committee, which has three independent (as defined in Marketplace Rule 4350(c)) members, two of whom are external directors under the Israeli Companies Law and meet the requirements of Nasdaq Marketplace Rule 4350(d)(2) and at least one of which meets the requirement of the Directive of the Israel Securities Authority that one non-employee member has financial and accounting skills to, among other things, understand, on a high level, matters relating to business, accounting, internal auditing and financial statements. See also Audit committee. In addition, our Board of Directors has not appointed a nominating committee as required by Nasdaq Marketplace Rule 4350(c)(4) and, instead, elected to follow Israeli law, which provides that a company may determine its method of nominating its directors. In our case, Board of Director members (other than the External Directors) are nominated by our Board of Directors, as is the custom in Israel. By law, shareholders holding at least 1% of a company's voting rights may nominate directors and our company complies with this law. External Directors are nominated by the board of directors and must be elected at the shareholders general meeting that must approve them by a majority and in addition, either (i) one third of the non-controlling shareholders participating in such vote have voted for such External Directors; or (ii) the shareholders opposing such nomination that are not controlling shareholders must not represent in excess of 1% of the total voting rights in the company.

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

As further described below, during 2007, Ituran spent \$4.9 million to repurchase 431,287 of its shares. This purchase had the result of decreasing total fully diluted shares, on a weighted average basis, for the year 2007 by 1,782 shares.

Set forth below is a summary of the shares repurchased by Ituran during 2007 and until the date hereof and the approximate dollar value of securities that may yet be purchased under its repurchase plan:

**Ituran Shares**

|               | Total number of<br>shares purchased(1) | Average price paid<br>per share<br>(U.S. dollars) | Total number of<br>shares purchased<br>as part of publicly<br>announced plans or programs | Approximate U.S. dollar value of<br>securities that may yet be<br>purchased under the plans<br>or<br>programs(2)<br>(in millions) |
|---------------|--|---|---|---|
| December 2007 | 431,287                                | 11.30   | 431,287   | 4,200,000   |
| January 2008  | 990,924                                | 11.34   | 990,924   | 2,900,000   |
| February 2008 | 144,306                                | 11.45   | 144,306   | 1,300,000   |
| May 2008      | 540,519                                | 13.13   | 540,519   | 4,200,000   |
| June 2008     | 159,435                                | 12.97   | 159,435   | 2,200,000   |
| Total         | 2,326,574                              |   | 2,326,574   |   |

(1) No securities were repurchased by the Company in 2007 except in the months listed.

(2) Amount available for repurchase under the Company's repurchase plan pursuant to authorization by the Company's board of directors in July 17, 2006. On January 24, 2008, our board of directors authorized an increase of the amount of the shares to be repurchased by the Company, to repurchase up to an aggregate of \$20 million of ordinary shares of the Company. As of the date of this report, the Company repurchased 2,326,574 ordinary shares (of which 924,433 were purchased by its subsidiary, Ituran Cellular Communications Ltd.).

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not Applicable.

**ITEM 18. FINANCIAL STATEMENTS**

The following consolidated financial statements and related registered public accounting firms' reports are filed as part of this annual report.

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**ITEM 19. EXHIBITS**

**Exhibit Number Description of Document**

- 1.1 Amended and Restated Articles of Association of the Company (1)
- 1.2 Form of Memorandum of Association of the Company (English Translation) (1)
- 2.1 Shareholders Agreement, dated May 18, 1998, by and between Moked Ituran Ltd., Moked Services, Information, Management, Investments, Yehuda Kahane Ltd., F.K. Generators and Equipment Ltd., Gideon Ezra, Ltd., Efraim Sheratzky, and Yigal Shani (English translation). (1)
- 2.2 Form of Amendment to Shareholders Agreement dated May 18, 1998, by and between Moked Ituran Ltd., Moked Services, Information, Management and Investments, Yehuda Kahane Ltd., F.K. Generators and Equipment Ltd., Gideon Ezra, Ltd., Efraim Sheratzky and/or T.S.D. Holdings Ltd., and Yigal Shani and/or G.N.S. Holdings Ltd. (English translation). (1)
- 4.1 Radio Location System License Agreement, dated December 16, 1993, by and between Pactel Teletrac and Tadiran Ltd. (1)
- 4.2 Assignment, Assumption, Consent and Amendment Agreement, dated April 30, 1996, by and between Teletrac, Inc, Airtouch Services, Tadiran Ltd. and the Registrant. (1)
- 4.3 Amendment Agreement (to Assignment, Assumption, Consent and Amendment Agreement dated April 30, 1996), dated March 1, 1999, by and between Teletrac, Inc. and the Registrant. (1)
- 4.4 Radio Location System License Agreement, dated July 13, 2004, by and between Teletrac, Inc., and Telematics Wireless Ltd. (1)
- 4.5 Radio Location System License Agreement, dated July 13, 1999, made by and among Teletrac, Inc., Teletrac License, Inc. and Ituran U.S.A. Inc. (1)
- 4.6 Amendment No. 1 to Radio Location System License Agreement, dated May 8, 2000, made by and among Teletrac, Inc., Teletrac License, Inc. and Ituran U.S.A. Inc. (1)
- 4.7 Integrated Base Station Unit Development Agreement, dated December 13, 1996, by and between Teletrac, Inc., Tadiran Telematics Ltd. (1)
- 4.8 License and Ownership Agreement, dated as of September 29, 1999, by and between Tadiran Telematics Ltd. and Teletrac, Inc. (1)
- 4.9

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Radio Location System License Agreement, dated March 1, 1999, by and between Teletrac, Inc. and Beheermaatschappij de Rooij B.V. (1)

- 4.10 Radio Location System License Agreement, dated December 21, 1999, by and between Teletrac, Inc. and Greenport Enterprises A.V.V., and assignment thereof to Ituran NY Corporation dated January 1, 2002. (1)
- 4.11 License and Supply Agreement for Radio Location System, dated August 31, 2004, by and between Vision Plant Inc. and Telematics Wireless Ltd. and ancillary Representation Agreement, dated June 2004 (1)\*

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- 4.12 Amendment No. 1 to the License and Supply Agreement for Radio Location System between Korean Location Information and Communications Company Ltd. and Telematics Wireless Ltd., dated June 15, 2005.(1)\*
- 4.13 Agreement for the Supply of Ituran Ltd. Radio Location System in greater China, dated August 29, 2004, by and between Golden Net Communication Technology Ltd., Ditrack (China) Group Co. Ltd. and Telematics Wireless Ltd., and ancillary Cooperation and Annex I-2-Beijing Ituran System Deployment in Beijing Statement of Work, Prices, and Terms of Payment, dated March 23, 2005. (1)\*
- 4.14 Cooperation Agreement, dated December 3, 2000, made by and between Arad Technologies Ltd. and Tadiran Telematics Ltd. (English translation). (1)\*
- 4.15 RMR Production Agreement, dated June 14, 2001, by and between Arad Technologies Ltd. and Tadiran Telematics Ltd.(1)\*
- 4.16 Appendix to the Cooperation Agreement and RMR Production Agreement, dated December 11, 2002, by and between Arad Technologies Ltd. and Telematics Wireless Ltd. (English translation). (1)\*
- 4.17 Second Appendix to the Cooperation Agreement and RMR Production Agreement, dated December 28, 2003, by and between Arad Technologies Ltd. and Telematics Wireless Ltd. (English translation). (1)\*
- 4.18 Third Appendix to the Cooperation Agreement and RMR Production Agreement, dated December 28, 2004, made by and between Arad Technologies Ltd. and Telematics Wireless Ltd. (English translation).(1)\*
- 4.19 CIH-Transponders Supply Agreement, dated December 3, 2000, by and between Derech Eretz Highways (1997) Ltd. and Tadiran Telematics Ltd. (1)
- 4.20 Agreement with an Independent Contractor, dated February 1, 2003, by and between the Registrant, Izzy Sheratzky, and A. Sheratzky Holdings Ltd. (English translation). (1)
- 4.21 Agreement with an Independent Contractor, dated September 5, 2002, by and between the Registrant, Eyal Sheratzky, and A. Sheratzky Holdings Ltd., addendum thereof, dated October 28, 2002, and resolution of the Registrant's shareholders dated February 24, 2004 (English translation). (1)
- 4.22 Agreement with an Independent Contractor, dated September 5, 2002, by and between the Registrant, Nir Sheratzky, and A. Sheratzky Holdings Ltd., addendum thereof, dated October 28, 2002, and resolution of the Registrant's shareholders dated February 24, 2004 (English translation). (1)
- 4.23 Individual Employment Agreement, dated August 1, 1995, by and between Moked Ituran Partnership (1995) and Jacob Suet (English translation). (1)
- 4.24 Individual Employment Agreement, dated August 20, 1995, by and between Moked Ituran Partnership (1995) and Harel Broida (English translation). (1)
- 4.25 Individual Employment Agreement, dated July 15, 1998, by and between Moked Ituran Partnership (1995) and Shlomo Kaminsky (English translation). (1)
- 4.26 Consulting Services Agreement, dated March 23, 1998, by and between the Registrant and Yehuda Kahane Ltd., including addendum thereof, as of May 25, 2003 (English translation). (1)

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- 4.27 Agreement, dated December 30, 2002, by and between the Registrant, Eddy Kafry, Avri Franko, Roman Sternberg and Telematics Wireless Ltd. (English translation) (1)
- 4.28 Unprotected Lease Agreement, dated February 7, 2002, by and between Mofari Ltd. and the Registrant and addendum thereof, dated February 19, 2002 (English translation) (1)
- 4.29 Lease Agreement, dated September 13, 1998, by and between Tadiran, Ltd. and Tadiran Telematics, Ltd., and addendum thereof, dated May 29, 2002 (English translation). (1)
- 4.30 Lease Agreement, dated May 29, 2002, by and between Rinat Yogev Nadlan and Ituran Cellular Communication Ltd. (English translation). (1)
- 4.31 Deed of undertaking and indemnification, dated November 12, 2000, executed by the Registrant to the benefit of Bank Hapoalim, B.M. on behalf of Ituran Localizacao e Controle (English translation). (1)
- 4.32 Indenture, dated August 6, 2001, by the Registrant for the benefit of Bank Hapoalim, B.M. (English translation). (1)
- 4.33 Indenture, dated January 29, 2002, by the Registrant for the benefit of Bank Hapoalim, B.M. (floating lien) (English translation). (1)
- 4.34 Indenture, dated January 29, 2002, by the Registrant for the benefit of Bank Hapoalim, B.M. (English translation). (1)
- 4.35 Deed of undertaking for repayment of loan, dated May 20, 2004, made by the Registrant in favor of Bank Hapoalim, B.M. (English translation). (1)
- 4.36 Lease Agreement, dated March 16, 2000, by and between Teleran Localizacao e Controle Ltda. and T4U Holding B.V., and addendum thereof, dated May 31, 2000. (1)
- 4.37 Lease Agreement, dated November 23, 2001, by and between Ituran de Argentina S.A. and El Sr. Mario Galuppo (English translation). (1)
- 4.38 Lease Agreement, dated September 7, 2001, by and between Ituran de Argentina S.A. and El Sr. Gustavo Eduardo Bazan (English translation). (1)
- 4.39 Form of Directors Letter of Indemnity (English translation). (1)
- 4.40 Form of Underwriting Agreement (1)
- 4.41 Agreement with Mapa dated April 26, 2007 (2)
- 4.42 Share Purchase Agreement between dated as of November 15, 2007 by and between Ituran Location and Control Ltd., Telematics Wireless Ltd. and ST Electronics (Info-Comm Systems) Pte Ltd.
- 4.43 Frame Product and Services Purchase Agreement dated as of January 1, 2008 by and between Ituran Location and Control Ltd. and Telematics Wireless Ltd.\*\*
- 8 List of significant subsidiaries
- 12.1 Certification by chief executive officer as required by Rule 13a-14(a).

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- 12.2 Certification by person serving in the capacity of chief financial officer as required by Rule 13a-14(a).
  - 13 Certification by co-chief executive officers and the person serving in the capacity of chief financial officer as required by Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.

- (1) Incorporated by reference to Registrant's Registration Statement on Form F-1 (File No. 333-128028) filed on September 23, 2005.
- (2) Filed as an exhibit to the annual report on Form 20-F for the year ended December 31, 2006 and incorporated herein by reference.



\* Certain portions of this exhibit have been omitted pursuant to an order granting confidential treatment by the United States Securities and Exchange Commission. The omitted non-public information has been filed with the United States Securities and Exchange Commission

\*\* Certain portions of this exhibit have been omitted pursuant to a request for an order granting confidential treatment by the United States Securities and Exchange Commission.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**Consolidated Financial Statements**

**as of December 31, 2007**

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**Consolidated Financial Statements**

**as of December 31, 2007**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
TO THE SHAREHOLDERS OF  
ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**Fahn Kanne & Co.**  
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We have audited the accompanying consolidated balance sheets of **Ituran Location and Control Ltd. (the Company)** and its subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, statements of changes in shareholders' equity and statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM TO THE SHAREHOLDERS OF ITURAN

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of cash flows for each of the three years in the period ended December 31, 2007. These consolidated financial statements are the responsibility of the Board of Directors and management of the Company. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We did not audit the 2007 and 2006 financial statements of two subsidiaries, whose assets included in the consolidation constituted approximately 18% and 20% of total consolidated assets as of December 31, 2007 and 2006, respectively, and whose revenues included in the consolidation constituted approximately 33% and 32% of total consolidated revenues for the years ended December 31, 2007 and 2006, respectively. The financial statements of these subsidiaries were audited by other independent auditors, whose reports have been furnished to us. Our opinion, insofar as it relates to the amounts included in respect of these companies, is based solely on the reports of the other independent auditors.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the Board of Directors and management of the Company, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other independent auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other independent auditors, 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, 2007 and 2006, and the consolidated results of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria) and our report dated June 30, 2008 expressed an adverse opinion thereon.

Fahn Kanne & Co.  
Certified Public Accountants (Isr.)  
Member firm of Grant Thornton International

Tel-Aviv, Israel  
June 30, 2008

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### ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

#### CONSOLIDATED BALANCE SHEETS

| (in thousands)   | US dollars     |                      |
|--|----------------|----------------------|
|  | 2007           | December 31,<br>2006 |
| <b>Current assets</b>  |                |                      |
| Cash and cash equivalents                                    | 28,669         | 43,812               |
| Investments in marketable securities                         | 9,558          | 16,034               |
| Accounts receivable (net of allowance for doubtful accounts) | 27,578         | 29,709               |
| Other current assets (Note 2)                                | 83,783         | 4,915                |
| Contracts in process, net (Note 3)                           | -              | 1,465                |
| Inventories (Note 4)   | 13,258         | 10,901               |
|  | <u>162,846</u> | <u>106,836</u>       |

|   |                |                |
|---|----------------|----------------|
| <b>Long-term investments and debit balances</b>     |                |                |
| Investments in affiliated companies (Note 5A)       | 191            | 881            |
| Investments in other companies (Note 5B)            | 1,678          | -              |
| Accounts receivable                                 | 49             | 123            |
| Loan to former employee                             | 560            | -              |
| Deposit   | -              | 1,457          |
| Deferred income taxes (Note 17)                     | 5,850          | 5,112          |
| Funds in respect of employee rights upon retirement | 2,513          | 4,001          |
|   | <u>10,841</u>  | <u>11,574</u>  |
| <b>Property and equipment, net</b> (Note 6)         | <u>24,440</u>  | <u>19,109</u>  |
| <b>Intangible assets, net</b> (Note 7)              | <u>8,801</u>   | <u>2,784</u>   |
| <b>Goodwill</b> (Note 8)                            | <u>9,631</u>   | <u>4,536</u>   |
| <b>Total assets</b>                                 | <u>216,559</u> | <u>144,839</u> |

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

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

| (in thousands, except share data)             | US dollars    |                      |
|---|---------------|----------------------|
|   | 2007          | December 31,<br>2006 |
| <b>Current liabilities</b>                    |               |                      |
| Credit from banking institutions (Note 9)     | 318           | 474                  |
| Accounts payable                              | 12,703        | 14,956               |
| Deferred revenues                             | 5,801         | 4,399                |
| Other current liabilities (Note 10)           | 33,592        | 13,573               |
|   | <u>52,414</u> | <u>33,402</u>        |
| <b>Long-term liabilities</b>                  |               |                      |
| Liability for employee rights upon retirement | 4,085         | 5,278                |
| Deferred income taxes (Note 17)               | 1,715         | 816                  |

|   |         |         |
|---|---------|---------|
|   | 5,800   | 6,094   |
| <b>Contingent liabilities, liens and guarantees</b> (Note 12)   |         |         |
| <b>Minority interests</b>   | 2,860   | 2,578   |
| <b>Capital Notes</b> (Note 13)  |         |         |
|   | 5,894   | 5,894   |
| <b>Shareholders' equity</b> (Note 14)   |         |         |
| Share capital - ordinary shares of NIS 0.33 par value:  | 1,983   | 1,971   |
| Authorized - December 31, 2006 and 2007 - 60,000,000 shares   |         |         |
| Issued and outstanding - December 31, 2006 - 23,321,507 shares, December 31, 2007 - 23,475,431 shares                                       |         |         |
| Additional paid-in capital  | 73,554  | 73,554  |
| Accumulated other comprehensive income (loss)   | 13,715  | 3,003   |
| Cost of Company shares held by the Company and its subsidiary - December 31, 2006 and 2007 - 80,839 shares and 491,390 shares, respectively | (5,900) | (1,261) |
| Retained earnings   | 66,239  | 19,604  |
| <b>Total shareholders' equity</b>   | 149,591 | 96,871  |
| <b>Total liabilities and shareholders' equity</b>   | 216,559 | 144,839 |

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

## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF INCOME

US dollars

| (in thousands except per share data) | 2007    | Year ended December 31,<br>2006 | 2005   |
|--------------------------------------|---------|---------------------------------|--------|
| <b>Revenues:</b>                     |         |                                 |        |
| Location-based services              | 64,634  | 54,048                          | 44,128 |
| Wireless communications products     | 60,204  | 50,004                          | 43,806 |
| Others                               | -       | -                               | 2,192  |
|                                      | 124,838 | 104,052                         | 90,126 |

#### Cost of revenues:

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|  |               |               |               |
|--|---------------|---------------|---------------|
| Location-based services  | 23,630        | 18,419        | 14,987        |
| Wireless communications products                                     | 44,009        | 35,434        | 30,956        |
| Other  | -             | -             | 1,643         |
|  | <u>67,639</u> | <u>53,853</u> | <u>47,586</u> |
| Gross profit   | 57,199        | 50,199        | 42,540        |
| Research and development expenses                                    | 2,991         | 2,682         | 2,799         |
| Selling and marketing expenses                                       | 8,218         | 5,123         | 4,876         |
| General and administrative expenses                                  | 22,629        | 17,659        | 14,959        |
| Other expenses (income), net (Note 15)                               | (49,138)      | 3             | (16)          |
| Operating income   | <u>72,499</u> | <u>24,732</u> | <u>19,922</u> |
| Financing income, net (Note 16)                                      | 1,227         | 1,886         | 906           |
| Income before taxes on income  | <u>73,726</u> | <u>26,618</u> | <u>20,828</u> |
| Taxes on income (Note 17)  | (20,953)      | (6,581)       | (5,295)       |
|  | <u>52,773</u> | <u>20,037</u> | <u>15,533</u> |
| Share in losses of affiliated companies, net                         | (516)         | (213)         | (355)         |
| Minority interests in income of subsidiaries                         | (783)         | (565)         | (803)         |
| Net income   | <u>51,474</u> | <u>19,259</u> | <u>14,375</u> |
| <b>Earnings per share (Note 18):</b>                                 |               |               |               |
| Basic  | <u>2.21</u>   | <u>0.83</u>   | <u>0.73</u>   |
| Diluted  | <u>2.20</u>   | <u>0.82</u>   | <u>0.71</u>   |
| <b>Weighted average number of shares outstanding (in thousands):</b> |               |               |               |
| Basic  | <u>23,315</u> | <u>23,194</u> | <u>19,736</u> |
| Diluted  | <u>23,422</u> | <u>23,457</u> | <u>20,254</u> |

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

ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands)

|  | Ordinary shares     |                            | Additional<br>paid in<br>capital | Accumulated<br>other<br>comprehensive<br>income (loss) | Retained<br>earnings<br>(accumulated<br>deficit) | Cost of Company<br>shares held by the<br>Company and its<br>subsidiaries | Total         |
|--|---------------------|----------------------------|----------------------------------|--|--|--|---------------|
|  | Number of<br>shares | Share<br>capital<br>amount |                                  |  |  |  |               |
| <b>US dollars</b>  |                     |                            |                                  |  |  |  |               |
| <b>Balance as of January 1, 2005</b>   | 18,595              | 1,626                      | 23,876                           | (2,487)  | (7,630)  | (384)  | 15,001        |
| <b>Changes during 2005:</b>  |                     |                            |                                  |  |  |  |               |
| Net income   | -                   | -                          | -                                | -  | 14,375   | -  | 14,375        |
| Losses on the translation of non-Israeli<br>currency financial statements of<br>subsidiaries and on translation of the<br>functional currency to the reporting<br>currency | -                   | -                          | -                                | (922)  | -  | -  | (922)         |
| <b>Total comprehensive income</b>  |                     |                            |                                  |  |  |  | 13,453        |
| Modification of terms of fully vested<br>employee stock options  | -                   | -                          | 243                              | -  | -  | -  | 243           |
| Issuance of share capital, net   | 4,464               | 325                        | 49,064                           | -  | -  | -  | 49,389        |
| Exercise of warrants   | 33                  | 2                          | 371                              | -  | -  | -  | 373           |
| Dividend paid  | -                   | -                          | -                                | -  | (2,697)  | -  | (2,697)       |
| <b>Balance as of December 31, 2005</b>   | <b>23,092</b>       | <b>1,953</b>               | <b>73,554</b>                    | <b>(3,409)</b>   | <b>4,048</b>                                     | <b>(384)</b>   | <b>75,762</b> |
| <b>Balance as of January 1, 2006</b>   | 23,092              | 1,953                      | 73,554                           | (3,409)  | 4,048  | (384)  | 75,762        |
| <b>Changes during 2006:</b>  |                     |                            |                                  |  |  |  |               |
| Net income   | -                   | -                          | -                                | -  | 19,259   | -  | 19,259        |
| Gain on translation of non-Israeli<br>currency financial statements of<br>subsidiaries and on translation of the<br>functional currency to the reporting<br>currency       | -                   | -                          | -                                | 6,412  | -  | -  | 6,412         |
| <b>Total comprehensive income</b>  |                     |                            |                                  |  |  |  | 25,671        |
| Exercise of options  | 230                 | 18                         | -                                | -  | -  | -  | 18            |
| Purchase of Company shares by the<br>Company   | -                   | -                          | -                                | -  | -  | (877)  | (877)         |
| Dividend paid  | -                   | -                          | -                                | -  | (3,703)  | -  | (3,703)       |
| <b>Balance as of December 31, 2006</b>   | <b>23,322</b>       | <b>1,971</b>               | <b>73,554</b>                    | <b>3,003</b>   | <b>19,604</b>                                    | <b>(1,261)</b>   | <b>96,871</b> |

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

ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (cont.)

(in thousands)

|   | Ordinary shares     |                            | Additional<br>paid in<br>capital | Accumulated<br>other<br>comprehensive<br>income (loss) | Retained<br>earnings<br>(accumulated<br>deficit) | Cost of Company<br>shares held by the<br>Company and its<br>subsidiaries | Total          |
|---|---------------------|----------------------------|----------------------------------|--|--|--|----------------|
|   | Number of<br>shares | Share<br>capital<br>amount |                                  |  |  |  |                |
| <b>US dollars</b>   |                     |                            |                                  |  |  |  |                |
| <b>Balance as of January 1, 2007</b>  | 23,322              | 1,971                      | 73,554                           | 3,003  | 19,604   | (1,261)  | 96,871         |
| <b>Changes during 2007:</b>   |                     |                            |                                  |  |  |  |                |
| Net income  | -                   | -                          | -                                | -  | 51,474   | -  | 51,474         |
| Gains on translation of non-Israeli<br>currency financial statements of<br>subsidiaries and on translation of the<br>functional currency to the reporting<br>currency | -                   | -                          | -                                | 10,712   | -  | -  | 10,712         |
| <b>Total comprehensive income</b>   |                     |                            |                                  |  |  |  | 62,186         |
| Exercise of options   | 154                 | 12                         | -                                | -  | -  | -  | 12             |
| Purchase of Company shares by the<br>Company  | -                   | -                          | -                                | -  | -  | (4,873)  | (4,873)        |
| Cost of Company shares held by<br>subsidiary that has been sold (see Note<br>1.A.1.d.)  | -                   | -                          | -                                | -  | -  | 234  | 234            |
| Dividend paid   | -                   | -                          | -                                | -  | (4,839)  | -  | (4,839)        |
| <b>Balance as of December 31, 2007</b>  | <b>23,476</b>       | <b>1,983</b>               | <b>73,554</b>                    | <b>13,715</b>  | <b>66,239</b>                                    | <b>(5,900)</b>   | <b>149,591</b> |

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

## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS

| (in thousands)  | US dollars              |        |        |
|---|-------------------------|--------|--------|
|   | Year ended December 31, |        |        |
|   | 2007                    | 2006   | 2005   |
| <b>Cash flows from operating activities</b>                                       |                         |        |        |
| Net income for the year   | 51,474                  | 19,259 | 14,375 |
| <b>Adjustments to reconcile net income to net cash from operating activities:</b> |                         |        |        |
| Depreciation and amortization   | 8,080                   | 4,205  | 3,341  |
| Exchange differences on principal of deposit and loans, net                       | (78)                    | (50)   | 104    |
| Gains in respect of marketable securities   | (437)                   | (200)  | -      |
| Gain from sale of subsidiary, net (Appendix A)                                    | (36,373)                | -      | -      |
| Increase (decrease) in liability for employee rights upon retirement              | 1,293                   | (187)  | 521    |
| Share in losses of affiliated companies, net                                      | 516                     | 213    | 355    |
| Deferred income taxes   | 991                     | 644    | 301    |
| Stock-based compensation  | -                       | -      | 243    |
| Capital gains on sale of property and equipment, net                              | (5)                     | (35)   | (16)   |
| Minority interests in income of subsidiaries, net                                 | 783                     | 565    | 803    |

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|   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|
| Increase in accounts receivable                       | (8,556)           | (3,668)           | (4,912)           |
| Decrease (increase) in other current assets           | 724               | (1,630)           | (1,028)           |
| Increase in inventories and contracts in process, net | (3,645)           | (4,435)           | (269)             |
| Increase in accounts payable                          | 1,799             | 2,686             | 460               |
| Increase (decrease) in deferred revenues              | (32)              | (1)               | 321               |
| Increase (decrease) in other current liabilities      | (3,773)           | 888               | 3,159             |
|   | <u>          </u> | <u>          </u> | <u>          </u> |
| Net cash provided by operating activities             | 12,761            | 18,254            | 17,758            |
|   | <u>          </u> | <u>          </u> | <u>          </u> |

**Cash flows from investment activities**

|   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|
| Increase in funds in respect of employee rights upon retirement, net of withdrawals | (678)             | (412)             | (288)             |
| Capital expenditures  | (9,641)           | (12,106)          | (3,540)           |
| Acquisition of subsidiary (appendix A)  | (8,549)           | (2,243)           | -                 |
| Proceeds from sale of property and equipment  | 195               | 53                | 133               |
| Purchase of intangible assets and minority interest                                 | (64)              | (58)              | (746)             |
| Investment in affiliated company  | (1,447)           | -                 | -                 |
| Investments in marketable securities  | (5,488)           | (55,863)          | -                 |
| Sale of marketable securities   | 13,982            | 40,848            | -                 |
| Loan granted to affiliated company  | -                 | (138)             | (452)             |
| Acquisition of additional interest in a subsidiary                                  | -                 | (21)              | -                 |
| Loan granted to former employee   | (560)             | -                 | -                 |
| Subsidiary no longer consolidated (Appendix B)                                      | (6,938)           | -                 | -                 |
|   | <u>          </u> | <u>          </u> | <u>          </u> |
| Net cash used in investment activities  | (19,188)          | (29,940)          | (4,893)           |
|   | <u>          </u> | <u>          </u> | <u>          </u> |

**Cash flows from financing activities**

|   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|
| Short-term credit from banking institutions, net    | 160               | (237)             | 181               |
| Repayment of long-term loans                        | (3,500)           | (3,191)           | (6,290)           |
| Dividend paid                                       | (4,839)           | (3,703)           | (2,697)           |
| Proceeds from exercise of options by employees      | 12                | 18                | 15                |
| Proceeds from exercise of warrants                  | -                 | -                 | 373               |
| Issuance of share capital, net                      | -                 | -                 | 49,673            |
| Dividend paid to minority interest of a subsidiary  | -                 | (172)             | -                 |
| Purchase of Company's shares                        | (4,873)           | (877)             | -                 |
|   | <u>          </u> | <u>          </u> | <u>          </u> |
| Net cash provided by (used in) financing activities | (13,040)          | (8,162)           | 41,255            |
|   | <u>          </u> | <u>          </u> | <u>          </u> |

|  |                   |                   |                   |
|--|-------------------|-------------------|-------------------|
| Effect of exchange rate changes on cash and cash equivalents | 4,324             | 5,231             | (295)             |
|  | <u>          </u> | <u>          </u> | <u>          </u> |
| Net increase (decrease) in cash and cash equivalents         | (15,143)          | (14,617)          | 53,825            |
| Balance of cash and cash equivalents at beginning of year    | 43,812            | 58,429            | 4,604             |
|  | <u>          </u> | <u>          </u> | <u>          </u> |
| Balance of cash and cash equivalents at end of year          | 28,669            | 43,812            | 58,429            |
|  | <u>          </u> | <u>          </u> | <u>          </u> |

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



**Appendix A Acquisitions of subsidiaries**

| US dollars   |                         |         |
|--|-------------------------|---------|
| (in thousands)   | Year ended December 31, |         |
|  | 2007                    | 2006    |
| Working capital (excluding cash and cash equivalents), net | 1,280                   | 2,015   |
| Deferred income taxes                                      | (1,583)                 | 54      |
| Funds in respect of employee rights upon retirement        | 408                     | 366     |
| Property and equipment, net                                | 397                     | 231     |
| Intangible assets, net                                     | 6,719                   | -       |
| Goodwill   | 5,220                   | 1,631   |
| Liability for employee rights upon retirement              | (729)                   | (559)   |
| Long term loan   | (3,163)                 | -       |
| Minority interest  | -                       | (1,495) |
|  | 8,549                   | 2,243   |

**Appendix B Company no longer consolidated**

| US dollars   |                         |      |
|--|-------------------------|------|
| (in thousands)   | Year ended December 31, |      |
|  | 2007                    | 2006 |
| Working capital (excluding cash and cash equivalents and inventory), net | 50,031                  | -    |
| Inventory (including contracts in process)                               | (4,408)                 | -    |
| Funds in respect of employee rights upon retirement                      | (2,968)                 | -    |
| Deposit  | (1,680)                 | -    |
| Investment in affiliated company   | (144)                   | -    |
| Deferred income taxes  | (347)                   | -    |
| Property and equipment, net  | (1,254)                 | -    |
| Goodwill   | (479)                   | -    |
| Liability for employee rights upon retirement                            | 3,803                   | -    |
| Minority interest  | 757                     | -    |
| Gain from sale of subsidiary (*)   | (36,373)                | -    |
|  | 6,938                   | -    |

(\*) Net of income taxes in an amount of US\$ 13,734 thousand.

**Supplementary information on investing activities not involving cash flows**

At December 31, 2005, accounts payable and other credit balances included an amount of US\$ 299,000 in respect of issuance expenses.

At December 31, 2005, 2006 and 2007, trade payables included US\$ 196,000, US\$ 84,000 and US\$ 119,000, respectively, in respect of the acquisition of property and equipment.

**Supplementary disclosure of cash flow information**

US dollars

| (in thousands)    | 2007  | Year ended December 31,<br>2006 | 2005  |
|-------------------|-------|---------------------------------|-------|
| Interest paid     | 100   | 205                             | 324   |
| Income taxes paid | 9,625 | 4,864                           | 2,049 |

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

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 1 SIGNIFICANT ACCOUNTING POLICIES

##### A. General

##### 1. Operations

- a. Ituran Location and Control Ltd. (the Company) commenced operations in 1994. The Company and its subsidiaries (the Group) are engaged in the provision of location-based services and machine-to-machine wireless communications products for use in stolen vehicle recovery, fleet management and other applications.
- b. In November 2006, the Company completed the acquisition of 51% of the issued share capital of ERM Electronic Systems Limited (ERM) for \$2.8 Million. As a result of the purchase price allocation, the Company recognized goodwill in the amount of US\$ 1.6 million. ERM is an Israeli company that develops, manufactures, and markets innovative vehicle security, tracking, and management GSM-based communications solutions for the international market.
- c. On June 25, 2007, the Company completed the acquisition of 100% of the outstanding share capital of Mapa Mapping and Publishing Ltd. and Mapa Internet Ltd. (Mapa). Mapa provides geographic information (GIS) in Israel and is the owner of geographic information database for navigation in Israel.

The purchase price for the acquisition includes approx. US\$9.9 million that were paid to the shareholders of MAPA and an additional sum of approx. US\$3.1 million that was transferred to Mapa, which was used to repay Mapa's loans to its shareholders.

The acquisition was accounted for according to the purchase method of accounting, in accordance with FAS No. 141, Business Combinations and accordingly, the respective purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition (see Appendix A to the cash flow statement)

The results of operations of MAPA were included in the consolidated financial statements of the company commencing July 1, 2007.

The purchase price allocations included the following intangible assets acquired:

|               | US\$      |
|---------------|-----------|
| GIS data base | (1) 4,025 |

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|               |     |       |
|---------------|-----|-------|
| Customer base | (2) | 1,184 |
| Brand name    | (3) | 1,222 |
| Goodwill      | (4) | 5,767 |
| Other         |     | 973   |

- (1) The GIS database represents geographic information for navigation in Israel and is amortized using the straight-line method over its useful life, which is 10 years.
- (2) The customer base is amortized over its useful life, which is 5 years.
- (3) The brand name is amortized using the straight-line method over its useful life, which is 15 years.

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ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont.)

A. General (cont.)

1. Operations (cont.)

c. (cont.)

- (4) Goodwill represents the excess of the purchase price over the fair value of the net assets acquired. Goodwill will not be amortized and will be tested for impairment at least annually. Goodwill includes but is not limited to the synergistic value that could be realized by the Company from the acquisition.

Below are certain unaudited pro forma combined statement of operations data for the years ended December 31, 2007 and 2006, as if the acquisition of MAPA had occurred on January 1, 2007 and 2006, respectively, after giving effect to the purchase accounting adjustments, including amortization of certain identifiable intangible assets. This pro forma financial information is not necessarily indicative of the combined results that would have been attained had the acquisition taken place at the beginning of 2007 and 2006, respectively, nor is it necessarily indicative of future results.

| (in thousands, except earnings per share) | US dollars              |         |
|---|-------------------------|---------|
|   | Year ended December 31, |         |
|   | 2007                    | 2006    |
|   | (Unaudited)             |         |
| Revenues                                  | 128,808                 | 112,006 |
| Net income                                | 52,211                  | 21,394  |
| Earnings per share:                       |                         |         |
| Basic                                     | 2.24                    | 0.92    |

|         |      |      |
|---------|------|------|
| Diluted | 2.23 | 0.91 |
|---------|------|------|

- d. On December 31, 2007, the Company completed the sale of the subsidiary, Telematics Wireless Ltd. (Telematics), to a third party. Pursuant to the sale transaction, the Company sold its entire shareholdings of Telematics to the purchaser, for an amount of US\$ 80 million (based on a specified enterprise value of Telematics, following the purchase of a certain portion of Telematics shares by Telematics for the aggregate sum of US\$ 5 million).

The purchase price was subject to adjustments based on performance parameters of Telematics in the year 2007. The adjustment resulted in a reduction of the enterprise value and therefore reduction of the capital gain in an amount of US\$ 3.5 million.

However, based on performance parameters of Telematics in the year 2008, the reduction of the consideration might decrease up to US\$ 3.5 million.

The Company is required to deposit an amount of US\$ 7.5 million in an escrow account in order to ensure certain representations and warranties towards the buyer. Such amount will be released to the Company upon the second anniversary of the closing date, less pledging claims, if any, subject to the agreement. The escrow amount was deposited by the Company during January 2008, after receipt of the entire consideration from the buyer.

As a result of the transaction, the Company recorded a capital gain (net of direct expenses) in an amount of US\$ 50 million. The Company did not account for the transaction as a discontinued operation under the provisions of FAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets, since management intends to continue to be involved in the fields of activity of the disposed company and the company intends to continue to purchase products from Telematics.

Following the sale of Telematics, the Company and Telematics entered into 10 years product and service supply agreement and a revenue sharing agreement with respect to Telematics revenues in certain regions (see Note 12.D.2).

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont)

##### A. General (cont.)

##### 2. Functional currency and translation to the reporting currency

The functional currency of the Company and its subsidiaries located in Israel is the New Israeli Shekel (NIS), which is the local currency in which those entities operate. The functional currency of the foreign subsidiaries of the Group is their respective local currency.

The consolidated financial statements of the Company and all of its subsidiaries were translated into U.S. dollars in accordance with the principles set forth in *Statement of Financial Accounting Standards* (FAS) No. 52 of the U.S. Financial Accounting Standards Board (FASB). Accordingly, assets and liabilities were translated from local currencies to U.S. dollars using year-end exchange rates, and income and expense items were translated at average exchange rates during the year.

Gains or losses resulting from translation adjustments (which result from translating an entity's financial statements into U.S. dollars if its functional currency is different than the U.S. dollar) are reflected in shareholders' equity, under accumulated other comprehensive income (loss).

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Balances denominated in, or linked to foreign currency are stated on the basis of the exchange rates prevailing at the balance sheet date. For foreign currency transactions included in the statement of income, the exchange rates applicable on the relevant transaction dates are used. Transaction gains or losses arising from changes in the exchange rates used in the translation of such balances are carried to financing income or expenses.

The following table presents data regarding the dollar exchange rate and the Israeli CPI:

|   | Exchange rate<br>of one US dollar | Israeli CPI <sup>(*)</sup> |
|---|-----------------------------------|----------------------------|
| <b>At December 31,</b>                      |                                   |                            |
| 2007  | NIS 3.846                         | 120.90 points              |
| 2006  | NIS 4.225                         | 116.92 points              |
| 2005  | NIS 4.603                         | 117.04 points              |
| <b>Increase (decrease) during the year:</b> |                                   |                            |
| 2007  | (8.97%)                           | 3.4%                       |
| 2006  | (8.21%)                           | (0.1%)                     |
| 2005  | 6.85%                             | 2.38%                      |

(\*) Based on the Index for the month ending on each balance sheet date, on the basis of 1998 average = 100.

### 3. Accounting principles

The consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States ( US GAAP ).

### 4. Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with US GAAP 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 reporting periods. Actual results could differ from those estimates.

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont)

##### B. Principles of consolidation

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. In these financial statements, the term subsidiary refers to a company over which the Company exerts control (ownership interest of more than 50%), and the financial statements of which are consolidated with those of the Company. Significant intercompany transactions and balances were eliminated upon consolidation; profits from intercompany sales, not yet realized outside of the Group, were also eliminated.

##### C. Cash and cash equivalents

The Group considers all highly liquid investments, which include short-term bank deposits that are not restricted as to withdrawal or use, and short-term debentures, with original periods to maturity not exceeding three months, to be cash equivalents.

##### D. Marketable securities

The Company accounts for investments in marketable securities in accordance with Statement of Financial Accounting Standard No. 115, Accounting for Certain Investments in Debt and Equity Securities ( FAS No. 115 ). Management determines the appropriate classification of its investments in marketable securities at the time of purchase and reassesses such determinations at each balance sheet date.

As of December 31, 2007 and 2006, all securities covered by FAS No. 115 were designated by management as trading securities.

Trading securities are stated at market value. The changes in market value are carried to financial income or expenses.

Trading securities are bought and held principally for the purpose of selling them in the near term. Changes in the fair value based on closing market prices of the securities at the balance sheet date, represent unrealized gains and losses which are included in earnings.

Trading gains for the year 2007 amounted to approximately US\$ 547,000 in respect of trading securities held by the Company in the reporting periods (US\$ 773,000 in 2006).

**E. Company shares held by the Company and its subsidiary**

Company shares held by the Company and its subsidiaries are presented as a reduction of shareholders' equity, at their cost to the Company or to the subsidiary, under the caption Cost of Company shares held by the Company and its subsidiaries . Gains on sale of these shares, net of related income taxes, are recorded as additional paid-in capital.

Losses on the sale of such shares, net of related income taxes, are recorded as deductions from additional paid-in capital to the extent that previous net gains from sales are included therein, otherwise in retained earnings.

**F. Allowance for doubtful accounts**

The allowance for doubtful accounts is determined with respect to amounts the Group has determined to be doubtful of collection. In determining the allowance for doubtful accounts, the Company considers, among other things, its past experience with customers and the information available on such customers. See also Note 21A.

The allowance in respect of trade receivables at December 31, 2006 and 2007 was US\$ 532,000 and US\$ 754,000, respectively.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont)**

**G. Contracts in process**

The contracts in process are presented at cost, less customer advances, less the portion of the costs expensed in prior periods (concurrent with the applicable revenue based on percentage of completion), and less the entire expected loss on projects, if any.

Cost includes direct costs of materials, labor, subcontractors, and other direct costs.

As of December 31, 2007 (after the sale of Telematics), the Company does not have contracts in process

**H. Inventories**

Inventories are stated at the lower of cost or market. Cost is determined as follows: raw materials and finished products mainly on the basis of average cost; work in progress on the basis of direct production costs including materials, labor and subcontractors.

**I. Investment in affiliated companies**

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Investments in companies in which the Group has significant influence (ownership interest of between 20% and 50%) but less than a controlling interest, which are not subsidiaries ( affiliated companies ), are accounted for by the equity method. Income on intercompany sales, not yet realized outside of the Group, was eliminated.

Investments in such companies in which the company no longer has significant influence, are classified as investments in other companies . See J. Below.

### **J. Investment in other companies**

Non-marketable investments in other companies in which the Company does not have a controlling interest or significant influence are accounted for at cost, net of write down for any permanent decrease in value.

### **K. Derivatives**

The Company has a limited involvement with derivatives which do not qualify for hedge accounting under FAS No. 133, or which have not been designated as hedging instruments. Such derivatives are recognized in the balance sheet at their fair value, with changes in the fair value carried to the statements of income and included in financing income (expenses), net.

The Company did not use hedging instruments in the reported periods.

### **L. Property and equipment**

1. Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are depreciated on the straight-line method over the shorter of the estimated useful life of the property or the duration of the lease.
2. Rates of depreciation:

|   | %   |
|---|---|
| Operating equipment (mainly 10%-20%)      | 6.5-33  |
| Office furniture, equipment and computers | 7-33  |
| Vehicles                                  | 15  |
| Buildings                                 | 2.5   |
| Leasehold improvements                    | Duration of lease which is less or equal to useful life |

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### **NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont)**

### **M. Impairment of long-lived assets**

The Group's long-lived assets are reviewed for impairment in accordance with FAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. During 2007, the Company recorded an impairment loss, in an amount of US\$0.9 million. (See Notes 7 and 8).

### **N. Deferred income taxes**

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The Group accounts for income taxes in accordance with FAS No. 109, *Accounting for Income Taxes*. According to FAS No. 109, deferred income taxes are determined utilizing the asset and liability method based on the estimated future tax effects of differences between the financial accounting and the tax bases of assets and liabilities under the applicable tax law. Deferred tax balances are computed using the tax rates expected to be in effect at the time when these differences reverse. Valuation allowances in respect of the deferred tax assets are provided for if, based upon the weight of available evidence, it is more likely than not that all or a portion of the deferred income tax assets will not be realized.

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ( FIN 48 ), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize in its financial statements the impact of a tax position, if that position will more likely than not be sustained upon examination, based on the technical merits of the position.

The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in its provision for income tax.

The initial application of FIN 48 to the Company's tax positions did not have a material effect on the Company's Shareholders' Equity. See also Note 17K.

### O. Goodwill and intangible assets

Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets acquired in business combinations accounted for as purchases. According to the provisions of FAS No. 142, *Goodwill and Other Intangible Assets*, goodwill is not amortized but rather tested for impairment at least annually. As of December 31, 2006 and 2007, the Company has determined that there is no impairment with respect to Goodwill.

Intangible assets are amortized using the straight-line basis over their useful lives, to reflect the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with FAS No. 142, as follows

|                                    | Years |
|------------------------------------|-------|
| Technology usage rights and others | 10    |
| Licenses and patents               | 7     |
| Customer base                      | 5     |
| GIS database                       | 10    |
| Brand name                         | 15    |
| Other                              | 3-10  |

### P. Issuance costs of convertible capital notes

Costs incurred in respect of the issuance of convertible capital notes are deferred and expensed as financing expenses over the contractual life of the capital notes.

Since the original maturity of the Notes has already expired, the entire balance of the issuance cost has been amortized.

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont)

#### Q. Liability for employee rights upon retirement



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The Company's liability for employee rights upon retirement with respect to its Israeli employees is calculated, pursuant to Israeli severance pay law, based on the most recent salary of each employee 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 makes monthly deposits to insurance policies and severance pay funds. The liability of the Company is fully provided for.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn upon the fulfillment of the obligation pursuant to Israeli severance pay laws or labor agreements. The value of the deposited funds is based on the cash surrender value of these policies, and includes immaterial profits.

The liability for employee rights upon retirement in respect of the employees of the non-Israeli subsidiaries of the Company, is calculated on the basis of the labor laws of the country in which the subsidiary is located and is covered by an appropriate accrual.

Severance expenses for the years ended December 31, 2005, 2006 and 2007, amounted to US\$ 604,000, US\$ 421,000 and US\$ 967,000, respectively.

### **R. Revenue recognition**

Revenues are recognized in accordance with Staff Accounting Bulletin No. 104 *Revenue Recognition* when delivery has occurred and, where applicable, after installation has been completed, there is persuasive evidence of an agreement, the fee is fixed or determinable and collection of the related receivable is reasonably assured and no further obligations exist. In cases where delivery has occurred but the required installation has not been performed, the Company does not recognize the revenues until the installation is completed.

The Company's revenues are recognized as follows:

1. Revenues from sales are recognized when title and risk of loss of the product pass to the customer (usually upon delivery).
2. Revenues from installation services are recognized when the installation is completed.
3. Revenues from subscription fees are recognized over the duration of the subscription period.
4. The Company recognizes revenues as gross or net in accordance with EITF 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent (EITF 99-19). In most arrangements, the Company contracts directly with its end-user customers, it is the primary obligor and it carries all collectibility risk. Revenues under these arrangements are recorded on a gross basis.

In some cases, the Company is not considered as the primary obligor according to the criteria established in EITF 99-19, and serves only as distributors of products or services of other parties to end-user customers. In those instances, in accordance with EITF 99-19, the Company reports the revenues on a net basis.

5. Revenues from certain long-term contracts:

The Company recognizes certain long-term contract revenues, in accordance with Statement of Position (SOP) 81-1, Accounting for Performance of Construction-Type and Certain Production Type Contracts.

Pursuant to SOP 81-1, revenue is recognized under the percentage of completion method. The Company measures the percentage of completion based on output criteria, such as the number of units delivered or the progress of the engineering process (in contracts that require network buildup before end units are sold).

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont)

##### **R. Revenue recognition (cont.)**

5. Revenues from certain long-term contracts (cont.):

Provisions for estimated losses on uncompleted contracts are made during the period in which such losses are first identified, in the amount of the estimated loss on the entire contract.

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 of the parties to the contract, the consideration to be exchanged and the manner and terms of settlement. In all cases, the Company expects to perform its contractual obligations and the parties are expected to satisfy their obligations under the contract.

In contracts that do not meet all the abovementioned conditions, the Company utilizes zero estimates of profit; equal amounts of revenue and cost are recognized until results can be estimated with sufficient certainty.

Revenues and costs recognized pursuant to SOP 81-1 on contracts in process are subject to management estimates. Actual results could differ from these estimates.

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

7. Sale and leaseback transactions

The Company accounts for sale and leaseback transactions in accordance with the provisions of FAS No. 13, *Accounting for Leases* as amended by FAS No. 28, *Accounting for Sales with Leasebacks*.

Accordingly, with respect of a certain leaseback transaction that was determined to be an operating lease and involving the use of more than a minor part but less than substantially all of the asset sold, the entire profit on the sale was deferred and amortized in proportion to rental payments over the term of the lease. There was no recognition of any profit at the date of the sale since the present value of the minimum lease payments exceeded the amount of the profit.

**S. Warranty costs**

The Company provides a warranty for its products to end-users at no extra charge. The Company estimates the costs that may be incurred under its warranty obligation and records a liability at the time the related revenues are recognized.

Among the factors affecting the warranty liability are the number of installed units and historical percentages of warranty claims. The Company periodically assesses the adequacy of the recorded warranty liability and adjusts the amount to the extent necessary. To date, warranty costs and the related liabilities have not been material.

**T. Research and development costs**

1. Research and development costs (other than computer software-related expenses) are expensed as incurred. Grants received from the Government of Israel for development of approved projects are recognized as a reduction of expenses when the related costs are incurred.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont)**

**T. Research and development costs (cont.)**

2. Software Development Costs

FAS No. 86 *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*, requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

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Research and development costs incurred in the process of developing product improvements or new products, are generally expensed as incurred, net of grants received from the Government of Israel for development of approved projects. Costs incurred by the Company between the establishment of technological feasibility and the point at which the product is ready for general release are insignificant.

### 3. Purchased In-Process Research and Development

Purchased In-Process Research and Development ( IPR&D ) represents the value assigned in a purchase business combination to research and development projects of the acquired business that had commenced but had not yet been completed at the date of acquisition and which have no alternative use. In accordance with FAS No. 2 *Accounting for Research and Development Costs*, as clarified by FASB Interpretation No. 4, amounts assigned to IPR&D are expensed as part of the allocation of the purchase price of the business combination.

### U. Advertising costs

Advertising costs are expensed as incurred.

Advertising expenses for the years ended December 31, 2005, 2006 and 2007 amounted to US\$ 3.7 million, US\$ 3.8 million and US\$ 6.1 million, respectively.

### V. Issuance of shares by affiliated companies

Capital gains arising from the issuance of shares by affiliated companies to third parties are carried to income on a current basis. Capital gains arising from the issuance of shares by an affiliated company to the extent that the issuing company is a newly formed company are carried to additional paid in capital.

### W. Earnings per share

Basic earnings per share are computed by dividing net income by the weighted average number of shares outstanding during the year, net of the weighted average number of Company shares held by the Company and its subsidiaries.

In computing diluted earnings per share, basic earnings per share are adjusted to reflect the potential dilution that could occur upon the exercise of options granted under employee stock option plans, using the treasury stock method, and the conversion of the convertible capital notes, using the if-converted method. The assumed conversion of such convertible capital notes that have not been converted during the period, was based on the average quoted share prices prior to each balance date (see also Note 18).

### X. Stock-based compensation

Until December 31, 2005, the Group accounted for its employee stock option plans using the fair value based method of accounting prescribed by FAS No. 123, *Accounting for Stock-Based Compensation* as amended by FAS No. 148 and applied FAS No. 123 and Emerging Issue Task Force ( EITF ) No. 96-18, *Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, with respect to options issued to non-employees.

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont)

##### X. Stock-based compensation (cont.)

According to FAS No. 123, the fair value of stock options granted to employees is estimated on the date of grant using the Black-Scholes option-pricing model. The compensation cost is charged to expense over the vesting period using the graded method, an accelerated method which results in charging a greater portion of the value of options granted in the earlier years of their vesting period.

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Effective January 1, 2006, the Company adopted the provisions of FAS No. 123R, *Share-Based Payment* (FAS 123R), a revision of FAS No. 123 and Staff Accounting Bulletin No. 107 ( SAB 107 ), which was issued in March 2005 by the SEC.

FAS 123R eliminates the use of APB 25 (and related interpretations) and the intrinsic value method of accounting, and requires to recognize, the cost of employee services received in exchange for awards of equity instruments, based on the fair value of those awards at the grant date.

As mentioned above, throughout December 31, 2005, the Company accounted for employees stock-based compensation using the fair value based method of accounting under FAS 123, therefore, the adoption of FAS 123R, did not have a material effect on the Company's financial position or results of operations.

### **Y. Comprehensive income (loss)**

Comprehensive income, presented in shareholders' equity, includes, in addition to net income translation gains (losses) of non-Israeli currency financial statements of subsidiaries and affiliated companies and translation gains and losses from the translation of the functional currency to the reporting currency.

### **Z. Recently issued accounting pronouncements**

#### **FAS 157, Fair Value Measurements**

In September 2006, the FASB issued FAS 157, *Fair Value Measurements*. This Statement clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. However, FAS 157 does not require any new fair value measurement.

FAS 157 is effective for fiscal years beginning after November 15, 2007 and should be applied prospectively (with a limited form of retrospective application). On February, 2008, the FASB issued Staff Position ( FSP ) FAS 157-2, which delays the effective date of FAS 157 for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements. As applicable to the Company, FAS 157 (except as it relates to non-financial assets and liabilities as required under the provisions of FSP FAS 157-2), will be effective as of the year beginning January 1, 2008.

The Company does not expect the adoption of this statement to have a material effect on its consolidated financial statements.

#### **FAS 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement 115**

In February 2007, the FASB issued FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement 115* ( FAS 159 ). This pronouncement permits all entities to choose to elect, at specified election dates, to measure eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. FAS 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of FAS 157. An entity is prohibited from retrospectively applying FAS 159, unless it chooses early adoption of FAS 157 also. The company is currently assessing the impact of FAS 159, if any on its financial position and results of operations.

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### **NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (cont)**

##### **Z. Recently issued accounting pronouncements (cont.)**

###### **FAS 141(R), Business Combinations**

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In December 2007, the FASB issued FAS 141(R), *Business Combinations*. This Statement will replace FAS 141, *Business Combinations* ( FAS 141(R) ). FAS 141(R) retains the fundamental requirements of FAS 141 with respect to the implementation of the acquisition method of accounting ( the purchase method ) for all business combinations and for the identification of the acquirer for each business combination. This Statement also establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, how the acquirer recognizes and measures the goodwill acquired in a business combination and the disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

FAS 141(R) will apply prospectively to business combinations for which the acquisition date is on or after December 15, 2008 (January 1, 2009 for the Company). Early adoption of FAS 141(R) is prohibited. The Company has not yet evaluated this statement for the impact, if any, that it will have on the financial position and results of operations on the Company.

### **FAS 160, Noncontrolling Interests in Consolidated Financial Statements**

In December 2007, the FASB issued FAS 160, *Noncontrolling Interests in Consolidated Financial Statements* ( FAS 160 ). This Statement amends ARB 51 and establishes accounting and reporting standards for the noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. FAS 160 clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. FAS 160 is effective for fiscal years beginning on or after December 15, 2008 (January 1, 2009 for the Company). Early adoption of FAS 160 is prohibited. The Company has not yet determined the impact, if any, that FAS 160 will have on its financial position and results of operations.

### **Staff Accounting Bulletin 110**

In December 2007, the SEC issued Staff Accounting Bulletin 110 ( SAB 110 ) regarding the use of a simplified method, as discussed in SAB 107 ( SAB 107 ), in developing an estimate of expected term of plain vanilla share options in accordance with FAS 123 (revised 2004), *Share-Based Payment*. Until December 31, 2007, SAB 107 allowed the use of the simplified method. SAB 110 allows, under certain circumstances, to continue to accept the use of the simplified method beyond December 31, 2007. The Company believes that the adoption of SAB 110 will not have a material impact on its financial position and results of operations.

## **NOTE 2 OTHER CURRENT ASSETS**

### **Composition:**

|  | US dollars   |       |
|--|--------------|-------|
| (in thousands)   | December 31, |       |
|  | 2007         | 2006  |
| Prepaid expenses   | 903          | 806   |
| Government institutions                                  | 2,065        | 2,571 |
| Deferred taxes   | 61           | 633   |
| Advances to suppliers                                    | 558          | 784   |
| Employees  | 146          | 63    |
| Accounts receivable in respect of sale of subsidiary (*) | 79,844       | -     |
| Others   | 206          | 58    |
|  | 83,783       | 4,915 |

(\*) The entire amount was repaid during January 2008.

## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

**NOTE 3 CONTRACTS IN PROCESS, NET****Composition:**

| (in thousands)                         | US dollars   |              |
|--|--------------|--------------|
|  | December 31, |              |
|  | 2007         | 2006         |
| Cost of work                           | -            | 8,670        |
| Less portion expensed in prior periods | -            | (7,205)      |
|  | <u>-</u>     | <u>1,465</u> |
| Less advances from customers           | -            | -            |
|  | <u>-</u>     | <u>1,465</u> |

The contracts were carried out by a subsidiary of the Company which was sold in December 2007. See also Note 1.A.1.d.

**NOTE 4 INVENTORIES****Composition:**

| (in thousands)    | US dollars    |               |
|-------------------|---------------|---------------|
|                   | December 31,  |               |
|                   | 2007          | 2006          |
| Finished products | 11,954        | 6,427         |
| Raw materials     | 1,156         | 2,847         |
| Work in progress  | 148           | 1,627         |
|                   | <u>13,258</u> | <u>10,901</u> |

**NOTE 5 INVESTMENTS IN AFFILIATED AND OTHER COMPANIES****A. Investments in affiliated companies****1. Icomtrade Ltd. ( Icomtrade )**

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The Company holds 50% of the shares of Icomtrade.

The balance of the Company's investment in Icomtrade as of December 31, 2006 and 2007 was US\$ 185,000 and US\$ 191,000, respectively. As of December 31, 2006 and 2007, these balances included a loan in the amount of US\$ 186,000 and US\$ 204,000, respectively.

The loan is linked to the Israeli Consumer Price Index.

### 2. **MatysOnBoard Ltd. ( Matys )**

The Company holds 25% of the shares of Matys.

The balance of the Company's investment in MatysOnBoard Ltd. as of December 31, 2006 and 2007 was US\$ 300,000 and US\$ 0 respectively. As of December 31, 2006 and 2007, these balances included a loan in the amount of US\$ 667,000 and US\$ 688,000, respectively.

The loan is linked to the Israeli Consumer Price Index.

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### NOTE 5 INVESTMENTS IN AFFILIATED AND OTHER COMPANIES

##### B. Investments in other companies

##### 1. Locationet Systems Ltd. ( Locationet )

On December 31, 2006, the Company and a subsidiary held together 21.28% of the shares of Locationet (10.64% were held by each of the companies) and as the group had significant influence, the investment in Locationet was classified and accounted for as an investment in an affiliated company. On December 31, 2007, the Company completed the sale of the subsidiary (see Note 1A.1.d.), as a result of which, the Company no longer has significant influence in Locationet and therefore the investment was classified among investment in other companies and accounted for at cost. See Note 1.J.

The balance of the Company's investment in Locationet as of December 31, 2006 and 2007 was US\$396,000 and US\$80,000, respectively.

##### 2. Korea Location Information & Communications Ltd. ( KLIC )

The Company purchased 3.73% of the shares of KLIC in March 2007.

The balance of the Company's investment in Klic as of December 31, 2007 was US\$ 1,598,000.

#### NOTE 6 PROPERTY AND EQUIPMENT, NET

##### A. Composition:

|   | US dollars   |        |
|---|--------------|--------|
|   | December 31, |        |
| (in thousands)                            | 2007         | 2006   |
| Operating equipment                       | 32,628       | 25,224 |
| Office furniture, equipment and computers | 10,540       | 7,216  |

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|  |                             |                             |
|--|-----------------------------|-----------------------------|
| Land   | 1,091                       | 904                         |
| Buildings                                      | 3,238                       | 2,683                       |
| Vehicles                                       | 1,646                       | 1,020                       |
| Leasehold improvements                         | 1,629                       | 1,005                       |
|  | <u>50,772</u>               | <u>38,052</u>               |
| Less accumulated depreciation and amortization | (26,332)                    | (18,943)                    |
|  | <u>24,440<sup>(*)</sup></u> | <u>19,109<sup>(*)</sup></u> |

(\*) See Appendix A and B of Statements of Cash Flows, in respect of acquisition and sale of subsidiaries.

- B.** During June 2006, a subsidiary purchased an 8 storey office building, with office space of approximately 5,356 sq.m., for the amount of 7.5 million Brazilian Reals (approximately US\$ 3.3 million).
- C.** In the years ended December 31, 2005, 2006 and 2007, depreciation and amortization expense was US\$ 2.8 million, US\$ 3.7 million and US\$ 6 million, respectively and additional equipment was purchased in an amount of US\$ 3.5 million, US\$ 12.1 million and US\$ 9.6 million, respectively.

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ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

**NOTE 7 INTANGIBLE ASSETS, NET**

- A. Intangible assets, net, consisted of the following:**

| (in thousands)                                  | US dollars             |                    |                             |                        |
|---|------------------------|--------------------|-----------------------------|------------------------|
|   | December 31,<br>2006   | 2007               | December 31,<br>2007        | 2007                   |
|   | Unamortized<br>balance | Original<br>amount | Accumulated<br>amortization | Unamortized<br>balance |
| Technology usage rights                         | 570                    | 3,662              | (3,390)                     | 272                    |
| Purchase of licenses and patent<br>registration | 1,398                  | 2,514              | (1,514) <sup>(**)</sup>     | 1,000                  |
| GIS database <sup>(*)</sup>                     | -                      | 4,025              | (106)                       | 3,919                  |
| Customer base <sup>(*)</sup>                    | -                      | 1,184              | (62)                        | 1,122                  |
| Brand name <sup>(*)</sup>                       | -                      | 1,222              | (22)                        | 1,200                  |
| Others <sup>(*)</sup>                           | 816                    | 5,343              | (4,055) <sup>(**)</sup>     | 1,288                  |
|   | <u>2,784</u>           | <u>17,950</u>      | <u>(9,149)</u>              | <u>8,801</u>           |

(\*) Regarding additions to intangible assets during 2007, see Note 1A.1.c.

(\*\*) See B. below.

Amortization of intangible assets amounted to US\$ 526,000, US\$ 428,000 and US\$ 1,124,000 for the years ended December 31, 2005, 2006 and 2007, respectively. As of December 31, 2007, the estimated aggregate amortization of



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intangible assets for the next five years is as follows: 2008 US\$ 1,495,000; 2009 US\$ 1,183,000; 2010 US\$ 1,024,000; 2011 US\$ 852,000; 2012 US\$ 792,000.

- B.** During 2007, the Company recorded an amount of US\$ 366,000, as an impairment loss with respect to the licenses.

The impairment amount was included in other expenses (income), net, and is based on valuation performed by management.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 8 GOODWILL**

- A.** The changes in the carrying amount of goodwill for the years ended December 31, 2006 and 2007, are as follows:

| US dollars   |  |                               |  |              |
|--|--|-------------------------------|--|--------------|
|  | Wireless<br>communications<br>products | Location<br>based<br>services | Cellular<br>communications<br>services | Total        |
| (in thousands)   |  |                               |  |              |
| Balance as of January 1, 2006                                    | 900                                    | 1,602                         | 298                                    | 2,800        |
| <b>Changes during 2006:</b>                                      |  |                               |  |              |
| Goodwill resulting from acquisitions during the year (*)         | -                                      | 1,631                         | -                                      | 1,631        |
| Impairment   | -                                      | -                             | (71)                                   | (71)         |
| Translation differences  | 76                                     | 74                            | 26                                     | 176          |
| Balance as of December 31, 2006                                  | <u>976</u>                             | <u>3,307</u>                  | <u>253</u>                             | <u>4,536</u> |
| <b>Changes during 2007:</b>                                      |  |                               |  |              |
| Goodwill resulting from acquisitions during the year (**)        | 3,964                                  | 1,803                         | -                                      | 5,767        |
| Realization of goodwill in respect of sale of a subsidiary (***) | (479)                                  | -                             | -                                      | (479)        |
| Impairment (****)  | -                                      | (291)                         | (278)                                  | (569)        |
| Translation differences  | 96                                     | 255                           | 25                                     | 376          |
| Balance as of December 31, 2007                                  | <u>4,557</u>                           | <u>5,074</u>                  | <u>-</u>                               | <u>9,631</u> |

(\*) See Note 1A.1.b.

(\*\*) See Note 1A.1.c.

(\*\*\*) See Note 1A.1.d.

(\*\*\*\*) See Note B. below.

B. During 2007, the Company recorded an amount of US\$ 569,000, as an impairment loss with respect to goodwill.

The impairment amount was included in other expenses (income), net , and is based on valuation performed by management using the income approach.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 9 CREDIT FROM BANKING INSTITUTIONS**

**A. Composition:**

| (in thousands)                                      | Interest rates as of | US dollars        |                   |
|---|----------------------|-------------------|-------------------|
|   | December 31, 2007    | December 31, 2007 | December 31, 2006 |
|   | %                    |                   |                   |
| Revolving credit in NIS                             | 5.5                  | 318               | 133               |
| Current maturities of long-term loans (See Note 11) |                      | -                 | 341               |
|   |                      | <u>318</u>        | <u>474</u>        |

**B. Lines of credit**

Unutilized short-term lines of credit of the Group as of December 31, 2007, aggregated to US\$ 1.4 million.

**C. Liens** see Note 12B.

**NOTE 10 OTHER CURRENT LIABILITIES**

**Composition:**

| (in thousands)                                | US dollars        |                   |
|---|-------------------|-------------------|
|   | December 31, 2007 | December 31, 2006 |
| Accrued expenses                              | 12,594(*)         | 3,890             |
| Employees and institutions in respect thereof | 3,044             | 2,894             |
| Government institutions                       | 17,802(*)         | 6,683             |

|                         |               |               |
|-------------------------|---------------|---------------|
| Related party           | 58            | 57            |
| Advances from customers | -             | 39            |
| Others                  | 94            | 10            |
|                         | <u>33,592</u> | <u>13,573</u> |

(\*) Accrued expenses include US\$ 9,732 thousand and Government institutions include US\$ 13,734 thousand, as direct expenses and income tax, as a result of the sale of the subsidiary. See also Note 1A.1.d.

**NOTE 11 LONG-TERM LOANS FROM BANKING INSTITUTIONS**

**A. Composition:**

| (in thousands)          | US dollars        |                   |
|-------------------------|-------------------|-------------------|
|                         | December 31, 2007 | December 31, 2006 |
| US dollar-linked        | -                 | 337               |
| Unlinked (nominal NIS)  | -                 | 4                 |
| Less current maturities | -                 | (341)             |
|                         | <u>-</u>          | <u>-</u>          |

**B. Liens** see Note 12B.

**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 12 CONTINGENT LIABILITIES, LIENS AND GUARANTEES**

**A. Claims**

- The Company is involved in litigation with Leonardo L.P., a US-based hedge fund ( Leonardo ), arising from a financial transaction entered into between the Company and Leonardo in February 2000. Pursuant to the terms of this financial transaction, the Company received a cash investment of \$12 million in exchange for certain notes that were convertible into ordinary shares of the Company according to a pre-determined formula. Pursuant to the formula, the conversion price of the notes was the lower of NIS 67.3 (\$14.7) per share or an average trading price of the shares of the Company for a defined period prior to conversion. The conversion price was used to determine the number of shares into which the notes may be converted by dividing the notional principal amount of the notes, initially \$12 million, by the conversion price. On the date the notes were issued, March 2, 2000, the notes were convertible into approximately 720,000 of the ordinary shares of the Company. As part of the terms of this financial transaction, and, as required by the rules of the TASE where the ordinary shares of the Company are currently traded, the Company was required to seek the approval from the TASE for the issuance of the ordinary shares underlying the notes. The TASE approved the issuance of 2,250,000 of the ordinary shares of the Company as the number of registered shares that could be issued under the notes. The Company understood the

terms of the financial transaction with Leonardo to provide that, except in certain limited circumstances, the amounts advanced to the Company, together with accrued interest on these advances at the annual rate of 3.5%, would be repaid and satisfied solely through the delivery of ordinary shares and that under no circumstance would the Company be required to deliver more than 2,250,000 of its ordinary shares. The Company believes that Leonardo also recognized that there was a limit on the number of shares issuable under the notes, and in fact at no time on or prior to the maturity date of the notes did Leonardo seek to convert the notes for more than 2,250,000 of the ordinary shares of the Company. Prior to the maturity date of the notes, Leonardo converted approximately \$6.7 million of the notional principal amount of the notes into an aggregate of 2,241,594 of the ordinary shares of the Company. The Company believes that the holders of the notes are therefore only entitled to convert the balance of their notes into 8,406 shares, although in the pending litigation Leonardo has indicated that it does not believe that the notes were subject to any limit on the number of shares that could be issued to them on conversion and is seeking to recover damages based on this allegation.

The terms of the documents and agreements that comprise the financial arrangement with Leonardo contain provisions regarding the repayment and conversion of the notes which may be regarded as conflicting or subject to different interpretations. Accordingly, the Company believes that the matter may only be resolved through litigation in which the parties present evidence as to the proper meaning and operation of the repayment and conversion provisions of documents and agreements comprising the financing transaction with Leonardo.

The parties are currently in early stages of pleading the case before a district court in Israel and are in the process of undertaking discovery. In its pleadings, Leonardo is seeking alternative remedies and relief, including (a) the repayment in cash of the balance of the notes in the amount of approximately \$6.2 million (plus accrued interest and expenses), (b) the delivery to Leonardo of the maximum number of the ordinary shares of the Company into which the notes could have been converted on the maturity date without regard to the 2,250,000 share limitation, or 3,516,462 ordinary shares, plus additional monetary damages, or (c) the repayment of a cash amount equal to the amount obtained by multiplying the 3,516,462 shares mentioned in the preceding clause by the highest trading price of the ordinary shares of the Company between the maturity date and the date of the court's decision, plus interest or expenses.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 12 CONTINGENT LIABILITIES, LIENS AND GUARANTEES (cont.)**

**A. Claims (cont.)**

**1. (cont.)**

Although there can be no assurances as to the final outcome of this litigation, the Company believes that the maximum liability that it could have in this matter, assuming that a court rejects our interpretation of the agreements or determines that it has otherwise defaulted in the notes, is approximately \$9.6 million. In addition, in June, 2006, Leonardo was initially permitted to amend its claim to add an additional cause of action, claiming that on January 29, 2002, the Company also breached the same agreement because Moked Ituran Ltd. distributed some of the Company's shares to other parties, in violation of the covenant that entitles Leonardo the option to redeem the notes Moked Ituran to maintain at least 70% of the number of the Company's shares that they held at the time the Company entered into the financial transaction with Leonardo. Based on such alleged breach, Leonardo is seeking an additional alternative remedy of \$9.6 million, plus interest and expenses. The Company successfully appealed the decision allowing Leonardo to amend its claim on legal grounds and such permission was ultimately revoked by the court. Leonardo subsequently filed a request for leave to appeal such decision to the Israeli Supreme Court, which request was denied. Leonardo further requested two more times, and on separate occasions, to amend its claim with relation to the same said alleged breach. Leonardo's request was denied twice by the district court, and Leonardo requested the Supreme Court once again for leave to appeal the decisions. Leonardo's second request for leave to appeal the last decisions has not yet been decided. While the Company cannot predict the outcome of this case, if Leonardo prevails, the award to Leonardo of damages, either in cash or by delivery of the Company's ordinary shares, could result in significant costs to the Company, adversely affecting its results of operations. In addition, the issuance of the Company's ordinary shares to Leonardo may impact the share price of the Company's ordinary shares and would dilute its shareholders

ownership percentage.

2. On July 8, 2005, a class action was filed against a subsidiary of the Company, Ituran Florida Corporation, in the First Judicial District Court in Philadelphia, Pennsylvania. The lawsuit claims that Ituran Florida sent fax advertisements to the named plaintiff and the other members of the class allegedly in violation of the Telephone Consumer Protection Act of 1991. Ituran Florida filed a motion for judgment on the pleadings that such claims should not be aired as part of a class action. Such motion was denied by the court and the case is currently at the interrogatories and requests for production of information stage. The plaintiff agreed to limit the class action to Pennsylvania actions only and the maximum potential amount of damages that the Company estimates its subsidiary may be liable for pursuant to the provisions of the Telephone Consumer Protection Act if the plaintiffs prevail is approximately \$1.5 million in the aggregate for all class plaintiffs, plus punitive damages and expenses. The Company does not believe that the plaintiffs will prevail and, even if they do prevail, the Company does not believe that the resolution of this claim will have a material effect on revenues, operations or liquidity.

**B. Liens**

To guarantee the liabilities of the Group to banks, the Company has registered the following pledges:

On monies due and/or due in the future from the bank clearing house, as well as a first degree floating lien on all of the property and assets of the Company and on the insurance rights thereto.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 12 CONTINGENT LIABILITIES, LIENS AND GUARANTEES (cont.)**

- C.** The Company was declared a monopoly under the Israeli Restrictive Trade Practices Law, 1988, in the market for the provision of systems for the location of vehicles in Israel. Under Israeli law, a monopoly is prohibited from taking certain actions, such as predatory pricing and the provision of loyalty discounts, which prohibitions do not apply to other companies. The Israeli Antitrust Authority may further declare that the Company has abused its position in the market. Any such declaration in any suit in which it is claimed that the Company engages in anti-competitive conduct may serve as *prima facie* evidence that the Company is either a monopoly or that it has engaged in anti-competitive behavior. Furthermore, it may be ordered to take or refrain from taking certain actions, such as setting maximum prices, in order to protect against unfair competition.

**D. Commitments**

1. As of December 31, 2007, minimum future rentals under operating leases of buildings for periods in excess of one year were as follows: 2008 US\$ 1 million; 2009 US\$ 0.9 million; 2010 US\$ 0.9 million; 2011 US\$ 0.9 million; 2012 and thereafter US\$ 0.9 million.

The leasing fees expensed in each of the years ended December 31, 2005, 2006 and 2007, were US\$ 2.3 million, US\$ 2.7 million and US\$ 2.9 million, respectively.

2. In January 2008, the Company entered into a 10 year Frame Product and Service Purchase Agreement with Telematics, pursuant to which the Company and Telematics shall purchase from each other certain products and services as detailed in the agreement for a price and subject to other conditions as detailed in the agreement. In addition, each of the Company and Telematics undertook toward one another not to compete in each other's exclusive markets in the area of Teletrac system and technology or similar RF terrestrial location systems and technology. The agreement is for a term of 10 years, following which it shall be renewed automatically for additional consecutive 12 month periods, unless non-renewal notice is sent by one of the parties to the other.

Concurrently with the sale of Telematics, the Company and Telematics entered into a revenue sharing agreement, pursuant to which Ituran shall be entitled to a share of the sales revenues of Telematics in the Republic of Korea and in China from sale of end products and base stations to customers in such territories as well as from royalties received from customers of Telematics in such territories relating to the AVL applications. The revenue sharing scheme shall continue for a term of five (5) years from January 2008 and shall be paid on a

quarterly basis.

**NOTE 13 CAPITAL NOTES**

1. On February 7, 2000, the Company entered into an agreement with Leonardo L.P., a foreign company ( Leonardo ), for a private placement of capital notes in return for an amount of US\$ 12 million.

The capital notes were convertible into Company shares until the end of the three-year period following their date of issue. The capital notes entitle their holders (until such time as they are converted into shares) to interest of 3.5% per annum, to be paid in cash or to be added to the principal, at the discretion of the Company.

The capital notes were convertible into ordinary shares of the Company, par value NIS 0.33 each. During the first 90-day period following the issuance of the capital notes, the conversion rate was NIS 67.3 (US\$ 15.9) per share. Subsequently, the conversion rate was set as the lower of an amount of NIS 67.3 (US\$ 15.9) per share or an amount equal to the average of the lowest 10 prices of the share during the 60 trading-day period prior to the date of the conversion of the capital notes.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 13 CAPITAL NOTES (cont.)**

1. (cont.)

In 2000, 2001 and 2002, capital notes in an amount of US\$ 2.5 million were converted into 241,392 Company shares, US\$ 985,000 into 297,645 Company shares and US\$ 3.2 million into 1,702,557 Company shares, respectively. As of December 31, 2003 and thereafter, the outstanding balance of capital notes could be converted into 8,406 Company shares.

Since the inception of the agreement with Leonardo, through March 2003 (the original contractual maturity of the capital notes), the Company accrued interest in respect of the capital notes. The interest charge for the year 2003 amounted to US\$ 134,000.

The Company elected not to pay the interest in cash. The effect of the accrued interest was reflected in the number of shares issued.

As of the contractual maturity of the notes, the Company does not accrue any interest in respect of the capital notes

2. See Note 12(A)(1) for a discussion regarding a pending legal action in connection with the notes.

**NOTE 14 SHAREHOLDERS EQUITY**

**A. Share capital**

1. Composition:

| December 31,                     | 2007       | 2007                  | 2006       | 2006                  |
|----------------------------------|------------|-----------------------|------------|-----------------------|
|                                  | Registered | Issued and fully paid | Registered | Issued and fully paid |
| Ordinary shares of NIS 0.33 each | 60,000,000 | 23,475,431            | 60,000,000 | 23,321,507            |

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2. Since May 1998, the Company has been trading its shares on the Tel-Aviv Stock Exchange ( TASE ). On September 2005, the Company registered its Ordinary shares for trade in the United States. On that day, the Company issued 4,256,000 shares for an aggregate price of US\$ 55.3 million before issuance expenses (including 416,000 shares which were sold to the underwriters).
3. The Ordinary shares of the Company confer upon their holders the right to receive notice to participate and vote in general meetings of the Company and the right to receive dividends, if and when, declared.
4. As of December 31, 2007, 2.1% of the share capital of the Company is held by the Company. As of December 31, 2006, 0.35% of the share capital of the Company was held by the Company and its subsidiary.
5. Shares held by the Company and its subsidiaries have no voting rights.
6. On July 17, 2006, the board of the Company authorized the repurchase of ordinary shares up to US\$ 10 million. As of December 31, 2006 and 2007, the Company has purchased approximately 60,103 ordinary shares equal to US\$ 0.9 million and 431,287 ordinary shares equal to US\$ 4.9 million, respectively.  
  
On January 24, 2008, the Company's board of directors authorized an increase of the amount of the shares to be repurchased by the Company, to repurchase up to an aggregate of US\$ 20 million of ordinary shares of the Company. As of the date of this report, the Company repurchased 1,626,620 ordinary shares (of which 512,422 were purchased by its subsidiary, Ituran Cellular Communications Ltd.).
7. During September 2005, the Company's board of directors authorized the increase of the registered share capital of the Company to 60,000,000 shares.

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### ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

#### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### NOTE 14 SHAREHOLDERS' EQUITY (cont.)

##### A. Share capital (cont.)

8. On September 22, 2005, the Company effected a share split pursuant to which each of its ordinary shares was converted into 3 ordinary shares. Unless otherwise noted, all share and per share amounts for all periods presented have been retroactively restated to give effect to this share split.

##### B. Stock option plans of the Company

1. On August 23, 2001, the Company's Board of Directors approved an employee stock option plan (the 2001 Plan ) for the grant, without consideration, of up to 282,244 options, exercisable into 846,732 ordinary shares of NIS 0.33 par value of the Company to certain employees and senior executives of the Company and its subsidiaries. The exercise price of each option is NIS 1. 32,324 options were fully vested on the date of grant and the remaining options under the plan vest over a period of 1-3 years (mainly 3) based on the employment status of each grantee. Any option not exercised within 3 years after the date such option vests will expire. Through December 31, 2007, all options under the 2001 Plan were granted and fully vested and all the options were exercised.
2. The following table presents a summary of the status of the option plans as of December 31, 2005, 2006, 2007 and changes during the years ended on those dates:

| Year ended December 31, | 2007  | 2006   | 2005  |
|-------------------------|---|--------|---|
| Number                  | Weighted<br>average<br>exercise<br>price <sup>(*)</sup> | Number | Weighted<br>average<br>exercise<br>price <sup>(*)</sup> |
|                         |   |        |   |
|                         |   |        |   |
|                         |   |        |   |

|   |          |              |               |              |                |              |
|---|----------|--------------|---------------|--------------|----------------|--------------|
| Balance outstanding at beginning of year  | 51,308   | NIS 1        | 128,016       | NIS 1        | 180,035        | NIS 1        |
| Exercised                                 | (51,308) | NIS 1        | (76,708)      | NIS 1        | (68,951)       | NIS 1        |
| Granted                                   | -        | -            | -             | -            | 16,932(**)     | -            |
| Expired                                   | -        | NIS 1        | -             | NIS 1        | -              | NIS 1        |
| <b>Balance outstanding at end of year</b> | <b>-</b> | <b>NIS 1</b> | <b>51,308</b> | <b>NIS 1</b> | <b>128,016</b> | <b>NIS 1</b> |
| <b>Balance exercisable at end of year</b> | <b>-</b> | <b>NIS 1</b> | <b>51,308</b> | <b>NIS 1</b> | <b>128,016</b> | <b>NIS 1</b> |

(\*) Each option was exercisable into 3 shares.

(\*\*) On July 18, 2005, the relevant institutions of the Company, as required under the Israeli Companies Law, approved the issuance of fully vested options to replace those options that expired, at a per-share exercise price of NIS 1. The compensation expense with respect to such options amounted to US\$ 243,000. The options were exercised.

The aggregate intrinsic value of the balances outstanding and exercisable as of December 31, 2006, was US\$ 2,304 thousand. This amount represents the total intrinsic value, based on the Company's stock price of US\$ 15.05 as of December 31, 2006, less the weighted exercise price. This represents the potential amount received by the option holders had all option holders exercised their options as of that date.

The total intrinsic value of options exercised during the year ended December 31, 2007 was US\$ 1,845 thousand, based on the Company's stock closing price on the date of exercise.

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### NOTE 14 SHAREHOLDERS' EQUITY (cont.)

##### B. Stock option plans of the Company (cont.)

- During December 2000, in return for services rendered in connection with a transaction with a foreign company to raise funds through capital notes, the foreign company was offered 11,111 non-negotiable option warrants, exercisable into 33,333 ordinary shares of the Company, par value NIS 0.33 each, at a price of NIS 51.85 per share (US\$ 12.27). The options were fully vested on the date of grant and exercisable at any time after their allotment, but no later than December 31, 2005. The options were exercised during 2005.

The fair value of these options was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions: risk-free interest rate of 10%, dividend yield of 0%, volatility factors of the expected market price of the Company's ordinary shares of 30%, and expected life of the options of 3.5 years. The Company recorded deferred issuance costs in an amount of US\$ 162,000, which were amortized over the life of the capital notes.

- The rights of the shares issued upon exercise of the options and warrants are identical to those of the ordinary shares of the Company.

##### C. Retained earnings



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1. In determining the amount of retained earnings available for distribution as a dividend, the Israeli Companies Law stipulates that the cost of the Company's shares acquired by the Company and its subsidiaries (that are presented as a separate item in the statement of changes in shareholders' equity) must be deducted from the amount of retained earnings.
2. On January 2004, the board of directors of the Company approved its dividend distribution policy whereby the Company would distribute annually 25% of its net income on the basis of the results of the Company each year, on condition that such distribution would not prevent the Company from meeting its existing and future commitments when they come due.
3. Dividends are declared and paid in NIS. Dividends paid to shareholders outside Israel may be converted into dollars on the basis of the exchange rate prevailing at the date of payment.
4. In April 2005, the Company distributed a dividend of approximately US\$ 2.6 million (NIS 11.8 million), on the basis of the results of the Company for the year ended December 31, 2004.
5. In April 2006, the Company distributed a dividend of approximately US\$ 3.7 million (NIS 17.5 million), on the basis of the results of the Company for the year ended December 31, 2005.
6. In April 2007, the Company distributed a dividend in an amount of US\$ 4.8 million, on the basis of the results of the Company for the year ended December 31, 2006.
7. In February 2008, the Company declared a dividend in an amount of US\$ 30 million (NIS 108 million), on the basis of the results of the Company for the year ended December 31, 2007. The dividend was paid in April 2008.
8. Dividends paid per share in the years ended December 31, 2007, 2006 and 2005 were US\$ 0.21, US\$ 0.16 and US\$ 0.15, respectively.

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### ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

#### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

#### NOTE 15 OTHER EXPENSES (INCOME), NET

| (in thousands)                                     | US dollars              |      |      |
|--|-------------------------|------|------|
|  | Year ended December 31, |      |      |
|  | 2007                    | 2006 | 2005 |
| Capital gain on the sale of a subsidiary           | (50,107) <sup>(*)</sup> | -    | -    |
| Decline in value of goodwill and intangible assets | 935 <sup>(**)</sup>     | -    | -    |
| Other  | 34                      | 3    | (16) |
|  | (49,138)                | 3    | (16) |

(\*) See Note 1.A.1.d.

(\*\*) See Notes 7 and 8.

#### NOTE 16 FINANCING INCOME, NET

| US dollars   |                         |              |            |
|--|-------------------------|--------------|------------|
| (in thousands)                                     | Year ended December 31, |              |            |
|  | 2007                    | 2006         | 2005       |
| Interest expenses in respect of long-term loans    | (4)                     | (98)         | (331)      |
| Short-term interest expenses                       | (286)                   | (297)        | (210)      |
| Gains (losses) on derivative financial instruments | (157)                   | (229)        | 79         |
| Gains in respect of marketable securities          | 452                     | 773          | -          |
| Exchange rate differences and others, net          | 1,222                   | 1,737        | 1,368      |
|  | <u>1,227</u>            | <u>1,886</u> | <u>906</u> |

**NOTE 17 TAXES ON INCOME****A. Taxes on income included in the statements of income:**

| US dollars                         |                         |              |              |
|------------------------------------|-------------------------|--------------|--------------|
| (in thousands)                     | Year ended December 31, |              |              |
|                                    | 2007                    | 2006         | 2005         |
| <b>Income taxes (tax benefit):</b> |                         |              |              |
| Current taxes:                     |                         |              |              |
| In Israel                          | 17,616(*)               | 3,105        | 2,039        |
| Outside Israel                     | 3,902                   | 3,092        | 3,065        |
|                                    | <u>21,518</u>           | <u>6,197</u> | <u>5,104</u> |
| Deferred taxes:                    |                         |              |              |
| In Israel                          | (450) <sup>(*)</sup>    | 450          | 115          |
| Outside Israel                     | (541)                   | 195          | 186          |
|                                    | <u>(991)</u>            | <u>645</u>   | <u>301</u>   |
| Taxes in respect of prior years:   |                         |              |              |
| In Israel                          | 426                     | (261)        | (332)        |
| Outside Israel                     | -                       | -            | 222          |
|                                    | <u>426</u>              | <u>(261)</u> | <u>(110)</u> |
|                                    | <u>20,953</u>           | <u>6,581</u> | <u>5,295</u> |

(\*)

Including an amount of US\$ 13,734 thousand in respect of a capital gain from sale of subsidiary. See Note 1.A.1.d.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 17 TAXES ON INCOME (cont.)**

**B. Measurement of results for tax purposes under the Income Tax (Inflationary Adjustments) Law, 1985 (the Inflationary Adjustment Law )**

The Company and its Israeli subsidiaries report income for tax purposes in accordance with the provisions of the Inflationary Adjustments Law, whereby taxable income is measured in NIS, adjusted for changes in the Israeli Consumer Price Index.

Results of operations for tax purposes are measured in terms of earnings in NIS after adjustments for changes in the Israeli Consumer Price Index ( CPI ). Commencing January 1, 2008 this law is void and in its place there are transition provisions, whereby the results of operations for tax purposes are to be measured on a nominal basis.

**C. The Law for the Encouragement of Capital Investments, 1959 (the Investment Law )**

A certain Israeli subsidiary of the Company has been granted Approved Enterprise status according to the Investment Law, under several different investment programs. The subsidiary is entitled to tax benefits deriving from the execution of programs for investments in assets, in accordance with the certificates of approval granted in respect of these investment programs.

Taxable income derived from the Approved Enterprise is tax exempt for a period of two to four years commencing in the first year in which the subsidiary earns taxable income from the approved enterprise and is liable to a reduced corporate tax rate of up to 25% for an additional period of three to five years (up to a total of seven years for each investment program). The benefit period for each of the programs is limited to the earlier of twelve years from the year that the investment plan was implemented, or fourteen years from the year in which the approval was granted.

In the event of distribution of cash dividends out of income which was tax exempt as above, the subsidiary would have to pay the 25% tax in respect of the amount distributed. The Company has decided not to cause declaration of dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the subsidiary Company s Approved Enterprise .

On December 31, 2007, the Company completed the sale of this subsidiary.

**D. Reduction in corporate tax rates**

On July 25, 2005, the Israeli Parliament passed an amendment to the Income Tax Ordinance (No. 147) 2005, gradually reducing the tax rate applicable to the Company (regarding profits not eligible for approved enterprise benefits mentioned above) as follows: in 2006 31%, in 2007 29%, in 2008 27%, in 2009 26% and in 2010 and thereafter 25%.

**E. Non-Israeli subsidiaries**

Non-Israeli subsidiaries are taxed according to the tax laws and rates in their country of residence.

**F. Tax assessments**

The Company has received final tax assessments through the 2002 tax year. Two Israeli subsidiaries have received final tax assessments through the 2001 and 2006 tax years, respectively. The other subsidiaries have not been assessed since incorporation.

## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

## NOTE 17 TAXES ON INCOME (cont.)

## G. Carryforward tax losses

Carryforward tax losses of an Israeli subsidiary as of December 31, 2007 amount to US\$ 0.9 million.

Carryforward tax losses in Israel may be utilized indefinitely.

As of December 31, 2007, the Company's non-Israeli subsidiaries in Brazil and the United States have available estimated carryforward tax losses of approximately US\$ 1.2 million and US\$ 14.4 million, respectively.

Regarding the subsidiary in the United States, carryforward tax losses may be utilized until 2021.

H. The following is a reconciliation between the theoretical tax on pre-tax income, at the applicable Israeli tax rate, and the tax expense reported in the financial statements:

| (in thousands)  | US dollars              |              |              |
|---|-------------------------|--------------|--------------|
|   | Year ended December 31, |              |              |
|   | 2007                    | 2006         | 2005         |
| Pretax income   | 73,726                  | 26,618       | 20,828       |
| Statutory tax rate  | 29%                     | 31%          | 34%          |
| Tax computed at the ordinary tax rate   | 21,380                  | 8,252        | 7,082        |
| Non-deductible expenses   | 203                     | 201          | 251          |
| Tax in respect of approved enterprises and translation differences                        | -                       | (1,601)      | (2,142)      |
| Losses in respect of which no deferred taxes were generated                               | 500                     | 180          | -            |
| Utilization of losses of prior years in respect of which no deferred taxes were generated | -                       | (27)         | (1,317)      |
| Deductible financial income (expenses) recorded to additional paid-in capital             | (430)                   | (596)        | 1,038        |
| Taxes in respect of prior years   | (422)                   | (262)        | (110)        |
| Taxes in respect of withholding at the source from royalties                              | 108                     | 200          | 181          |
| Others  | (386)                   | 234          | 312          |
|   | <u>20,953</u>           | <u>6,581</u> | <u>5,295</u> |

## I. Summary of deferred taxes

## Composition:

US dollars

| (in thousands)  | Year ended<br>December 31, |      |
|---|----------------------------|------|
|   | 2007                       | 2006 |
| <b>Deferred taxes included in other current assets:</b> |                            |      |
| Provision for employee-related obligations              | 61                         | 136  |
| Other timing differences                                | -                          | 497  |
|   | 61                         | 633  |
| Valuation allowance                                     | -                          | -    |
|   | 61                         | 633  |
|   | 61                         | 633  |

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

## NOTE 17 TAXES ON INCOME (cont.)

## I. Summary of deferred taxes (cont.)

## Composition:

| (in thousands)                             | US dollars                 |         |
|--|----------------------------|---------|
|  | Year ended<br>December 31, |         |
|  | 2007                       | 2006    |
| <b>Long-term deferred income taxes:</b>    |                            |         |
| Provision for employee related obligations | 588                        | 449     |
| Carryforward tax losses                    | 5,460                      | 5,595   |
| Other timing differences, net              | 285                        | (336)   |
|  | 6,333                      | 5,708   |
| Valuation allowance                        | (2,198)                    | (1,412) |
|  | 4,135                      | 4,296   |
|  | 4,135                      | 4,296   |

## J. Income before income taxes is composed as follows:

US dollars

Year ended December 31,

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| (in thousands)                           | 2007                  | 2006          | 2005          |
|--|-----------------------|---------------|---------------|
| The Company and its Israeli subsidiaries | 65,763 <sup>(*)</sup> | 17,392        | 10,973        |
| Non-Israeli subsidiaries                 | 7,963                 | 9,226         | 9,855         |
|  | <u>73,726</u>         | <u>26,618</u> | <u>20,828</u> |

(\*) Including US\$ 50,107 thousand of a capital gain in respect of the sale of a subsidiary. See Note 1.A.1.d.

**K. Uncertain tax positions**

As stated in Note 1N, effective January 1, 2007, the Company adopted FIN 48, "Accounting for Uncertainty in Income Taxes" an interpretation of FAS 109, which was issued in July 2006. As of the date of adoption, there was no difference in the Company's tax contingencies under the provisions of FIN 48, since the amount of liability with respect to tax contingencies was fully provided. As a result, there was no effect on the Company's shareholders equity upon the Company's adoption of FIN 48.

The Company and its subsidiaries files income tax returns in Israel, US, Argentina and Brazil.

Reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|  | US dollars<br>(in thousands) |
|--|------------------------------|
| Balance at January 1, 2007                                   | 3,725                        |
| Additions based on tax positions related to the current year | <u>558</u>                   |
| Balance at December 31, 2007                                 | <u>4,283</u>                 |

The Company anticipates that it is reasonably possible that over the next twelve months the amount of unrecognized tax benefits could be reduced to zero, therefore as of December 31, 2007, the liability with respect to uncertain tax positions is presented as short-term liability in the balance sheet.

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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 18 EARNINGS PER SHARE**

The net income and the weighted average number of shares used in computing basic and diluted earnings per share for the years ended December 31, 2004, 2005 and 2006, are as follows:

|                | US dollars              |      |      |
|----------------|-------------------------|------|------|
| (in thousands) | Year ended December 31, |      |      |
|                | 2007                    | 2006 | 2005 |
|                |                         |      |      |

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|  |        |        |        |
|--|--------|--------|--------|
| Net income used for the computation of basic earnings per share                                  | 51,474 | 19,259 | 14,375 |
| The effect of inclusion of the earning of subsidiary based on its diluted earning per share, net | -      | -      | (217)  |
| Net income used for the computation diluted earning per share                                    | 51,474 | 19,259 | 14,158 |

| (in thousands)   | Number of shares        |        |        |
|--|-------------------------|--------|--------|
|  | Year ended December 31, |        |        |
|  | 2007                    | 2006   | 2005   |
| Weighted average number of shares used in the computation of basic income per share              | 23,315                  | 23,194 | 19,736 |
| <b>Add:</b>  |                         |        |        |
| Additional shares from the assumed exercise of employee stock options, net                       | 98                      | 254    | 509    |
| Weighted average number of additional shares issued upon the assumed conversion of capital notes | 9                       | 9      | 9      |
| Weighted average number of shares used in the computation of diluted income per share            | 23,422                  | 23,457 | 20,254 |

**NOTE 19 RELATED PARTIES**

- A.** The Tzivtit Insurance Ltd. ( Tzivtit Insurance ), owned by the director of the Company, serves as the Company's insurance agent and provides the Company with elementary insurance and managers insurance.

In respect of these insurance services, Tzivtit Insurance is entitled to receive commissions at various rates, paid by the insurance company (which is not considered a related party).

With respect to basic insurance policies, and directors and offices insurance policies, the Company pays US\$ 225 thousand and US\$ 256 thousand, respectively, per annum.

- B.** In February 2003, an agreement was signed between the Company and A. Sheratzky Holdings Ltd., a wholly-owned and controlled company belonging to Mr. Izzy Sheratzky, Chairman of the Company's Board of Directors. The agreement includes, among other things, the cost of Mr. Izzy Sheratzky's monthly employment in an amount of NIS 85,500 (US\$ 20,800), entertainment expenses, car maintenance expenses, cellular phone, and entitlement to participate in the profits of the Company in an amount equal to 5% of the pretax income of the Company, plus the share of the Company in the income or losses of affiliated companies, on the basis of the audited consolidated financial statements.

The agreement is for a two-year period, with automatic two-year extensions, unless either of the parties gives 180-day advance notice of its intention to terminate the agreement.

**NOTE 19**

**RELATED PARTIES (cont.)**

- C. On September 5, 2002, the Company entered into independent contractor agreements with A. Sheratzky Holdings and each of Eyal Sheratzky and Nir Sheratzky (the Co-CEOs of the Company), pursuant to which A. Sheratzky Holdings will provide management services to the Company through Eyal Sheratzky and Nir Sheratzky in consideration of monthly payments in the amount of NIS 48,892 and NIS 49,307 (US\$ 11,900 and US\$ 12,000), respectively, in addition to providing each of them a company car and reimbursement of certain business expenses. In January 2004, changes in the employment terms of the two Co-CEOs of the Company were approved, whereby each would be entitled to an annual bonus equal to 1% of the pretax income of the Company, plus the share of the Company in the income or losses of affiliated companies, on the basis of the audited consolidated financial statements.

The aggregate amounts paid to A. Sheratzky Holdings in 2005, 2006 and 2007 (including with respect to B. above), were approximately US\$ 1,480,000, US\$ 2,581,000 and US\$ 2,855,000, respectively (all numbers include value added tax).

- D. In March 1998, an agreement was approved with an interested party, Prof. Yehuda Kahane, for financial consulting, whereby the Company would pay the consultant monthly consulting fees of NIS 4,000 (US\$ 900), linked to the Israeli Consumer Price Index in respect of January 1998. In May 2003, the Company approved an increase in the consideration paid, to a total cost of NIS 15,000 (US\$ 3,370) a month, linked to the Israeli Consumer Price Index. The aggregate amount paid to Professor Kahane in each of the years 2006 and 2005 was approximately US\$ 47,000 and US\$ 50,800 in 2007.
- E. On January 23, 2007, the Company's subsidiary, E-Com Global Electronic Commerce Ltd. signed an agreement with Gil Sheratzky for the employment of Mr. Sheratzky as CEO of that company, in consideration of monthly payments in the amount of NIS 25,000 or US\$ 5,610, in addition to providing him a company car, managers insurance and education fund contribution (as customary in Israel) and reimbursement of certain business expenses. In his position, Mr. Sheratzky will report to the CEO. The compensation paid to Gil Sheratzky includes a bonus in an amount equal to 2% of the annual increase in that company's profits before tax (up to a maximum amount of 1% of that company's profits before tax), based on its audited consolidated financial statements for the relevant year, beginning January 1, 2007.

**NOTE 20**

**SEGMENT REPORTING**

**A. General information:**

The operations of the Company are conducted through two different core activities: Location-Based Services and Wireless Communications Products. These activities also represent the reportable segments of the Company.

The reportable segments are viewed and evaluated separately by Company management, since the marketing strategies, processes and expected long term financial performances of the segments are different.

Commencing in 1999 and ending in March 2005, the Company, through its subsidiary, Ituran Cellular Communications Ltd., was engaged in the installation of hands-free equipment in cars, and the sale of cellular lines and equipment under an exclusivity agreement with Partner Communications Co. Ltd. In view of the fact that, as of April 1, 2005, this activity is no longer material, it ceased being a reportable segment and is presented below as "Other".

**Location-based services:**

The location-based services segment consists predominantly of regionally-based stolen vehicle recovery (SVR) services, fleet management services and value-added services comprised of personal advanced locater services and concierge services.

The Company provides location-based services in Israel, Brazil, Argentina and the United States.

**Wireless communications products:**

The wireless communications product segment consists of short and medium range two-way machine-to-machine wireless communications products that are used for various applications, including automatic vehicle location, automated meter reading and automatic vehicle identification. The Company sells products to customers in Israel, Argentina, Brazil, the United States, China and Korea.



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**ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)**

**NOTE 20 SEGMENT REPORTING (cont.)**

**B. Information about reported segment profit or loss and assets:**

| US dollars                          |                                |  |       |          |
|-------------------------------------|--------------------------------|--|-------|----------|
| (in thousands)                      | Location-<br>based<br>services | Wireless<br>communications<br>products | Other | Total    |
| <b>Year ended December 31, 2005</b> |                                |  |       |          |
| Revenues                            | 44,128                         | 43,806                                 | 2,192 | 90,126   |
| Operating income                    | 13,024                         | 6,666                                  | 232   | 19,922   |
| Assets                              | 124                            | 19,406                                 | 189   | 19,719   |
| Goodwill                            | 1,602                          | 900                                    | 298   | 2,800    |
| Expenditures for assets             | -                              | 714                                    | -     | 714      |
| Depreciation and amortization       | -                              | 200                                    | 53    | 253      |
| <b>Year ended December 31, 2006</b> |                                |  |       |          |
| Revenues                            | 54,048                         | 50,004                                 | -     | 104,052  |
| Operating income                    | 16,648                         | 8,084                                  | -     | 24,732   |
| Assets                              | 418                            | 33,835                                 | 88    | 34,341   |
| Goodwill                            | 1,675                          | 2,607                                  | 254   | 4,536    |
| Expenditures for assets             | -                              | 2,459                                  | -     | 2,459    |
| Depreciation and amortization       | -                              | 357                                    | -     | 357      |
| <b>Year ended December 31, 2007</b> |                                |  |       |          |
| Revenues                            | 64,634                         | 60,204                                 | -     | 124,838  |
| Operating income                    | 16,227                         | 56,272(*)                              | -     | 72,499   |
| Assets                              | 743                            | 7,048                                  | 98    | 7,889(*) |
| Goodwill                            | 4,273                          | 5,358                                  | -     | 9,631(*) |
| Expenditures for assets             | 2,251                          | 631                                    | -     | 2,882    |
| Depreciation and amortization       | 57                             | 500                                    | -     | 557      |

(\*) Including an amount of US\$ 50,107 thousand in respect of a capital gain on the sale of a subsidiary. See Note 1.A.1.d.

**C. Information about reported segment profit or loss and assets:**

- The evaluation of performance is based on income from operations of each of the reportable segments.
- Accounting policies of the segments are the same as those described in the accounting policies applied in the financial statements.
- Due to the nature of the reportable segments, there have been no inter-segment sales or transfers during the reported periods.
- Financing expenses, net, other expenses, net, taxes on income, minority interests and the share of the Company in losses of affiliated companies were not allocated to the reportable segments, since these items are carried and evaluated on the enterprise level.

## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

## NOTE 20 SEGMENT REPORTING (cont.)

## D. Reconciliations of reportable segment revenues, profit or loss, and assets, to the enterprise's consolidated totals:

| (in thousands)   | US dollars              |            |           |
|--|-------------------------|------------|-----------|
|  | Year ended December 31, |            |           |
|  | 2007                    | 2006       | 2005      |
| <b>Total revenues of reportable segment and consolidated revenues</b>    | 124,838                 | 104,052    | 90,126    |
| <b>Operating income</b>  |                         |            |           |
| Total operating income for reportable segments                           | 72,499                  | 24,732     | 19,922    |
| Unallocated amounts:   |                         |            |           |
| Financing income (expenses), net   | 1,227                   | 1,886      | 906       |
| Consolidated income before taxes on income taxes and extraordinary items | 73,726                  | 26,618     | 20,828    |
| <b>Assets</b>  |                         |            |           |
| Total assets for reportable segments                                     | 17,520(*)               | 38,877(*)  | 22,519(*) |
| Other unallocated amounts:   |                         |            |           |
| Current assets   | 156,340                 | 79,501     | 75,565    |
| Investments in affiliated companies                                      | 1,869                   | 881        | 872       |
| Property and equipment, net  | 24,152                  | 17,162     | 8,885     |
| Other assets   | 8,449                   | 2,423      | 2,873     |
| Other unallocated amounts  | 8,229                   | 5,995      | 5,770     |
| Consolidated total assets (at year end)                                  | 216,559                 | 144,839    | 116,484   |
| <b>Other significant items</b>   |                         |            |           |
| Total expenditures for assets of reportable segments                     | 2,628                   | 2,459      | 714       |
| Unallocated amounts  | 19,409                  | 11,567     | 3,129     |
| Consolidated total expenditures for assets                               | 22,041(**)              | 14,026(**) | 3,843(**) |
| Total depreciation and amortization for reportable segments              | 557                     | 357        | 253       |

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|  |       |       |       |
|--|-------|-------|-------|
| Unallocated amounts                              | 7,523 | 3,851 | 3,088 |
| Consolidated total depreciation and amortization | 8,080 | 4,208 | 3,341 |

(\*) Including goodwill.

(\*\*) Including long-lived assets allocated to segments acquired through acquisition of subsidiaries.

ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

NOTE 20 SEGMENT REPORTING (cont.)

E. Geographic information

| (in thousands)  | Revenues       |                      |               |
|-----------------|----------------|----------------------|---------------|
|                 | 2007           | December 31,<br>2006 | 2005          |
| Israel          | 57,283         | 39,587               | 40,622        |
| United States   | 19,825         | 19,914               | 13,686        |
| Brazil          | 33,125         | 25,821               | 21,015        |
| Argentina       | 10,206         | 9,852                | 9,063         |
| China and Korea | 4,399          | 8,878                | 5,740         |
| <b>Total</b>    | <b>124,838</b> | <b>104,052</b>       | <b>90,126</b> |

| (in thousands) | Property and equipment, net |                      |              |
|----------------|-----------------------------|----------------------|--------------|
|                | 2007                        | December 31,<br>2006 | 2005         |
| Israel         | 4,804                       | 4,658                | 3,630        |
| United States  | 128                         | 353                  | 687          |
| Brazil         | 15,008                      | 11,035               | 2,993        |
| Argentina      | 4,500                       | 3,063                | 2,594        |
| <b>Total</b>   | <b>24,440</b>               | <b>19,109</b>        | <b>9,904</b> |

- Revenues were attributed to countries based on customer location.

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- Property and equipment were classified based on major geographic areas in which the Company operates.

### F. Major customers

During 2005, 2006 and 2007, sales to a certain single customer amounted to 9.26%, 12.7% and 10.8%, respectively, of the total revenues. Apart from this customer, there were no sales exceeding 10% of total revenues during the reported periods.

## NOTE 21 FINANCIAL INSTRUMENTS AND RISKS MANAGEMENT

### A. Concentrations of credit risks

Most of the Group's cash and cash equivalents and short-term investments (including investments in marketable securities), as of December 31, 2006 and 2007, were deposited with major Israeli banks. The Company is of the opinion that the credit risk in respect of these balances is immaterial.

Most of the Group's sales are made in Israel, South America and the United States, to a large number of customers, mainly to insurance companies. Accordingly, the Group's trade receivables do not represent a substantial concentration of credit risk.

One of the subsidiaries of the Company performed under long-term contracts with several unrelated parties. At the time of initiation, the subsidiary checks the credit worthiness of the party to each contract, but generally does not require collateral. However, in certain circumstances, the Company or the subsidiary may require a letter of credit, other collateral, or additional guarantees of advance payment.

On December 31, 2007, the Company sold this subsidiary. See Note 1.A.1.d.

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## ITURAN LOCATION AND CONTROL LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (cont.)

## NOTE 21 FINANCIAL INSTRUMENTS AND RISKS MANAGEMENT (cont.)

### B. Fair value of financial instruments

The fair value of the financial instruments included in the working capital of the Group (cash and cash equivalents, investment in marketable securities, accounts receivable, accounts payable and other current liabilities) approximates their carrying value, due to the short-term maturity of such instruments.

As the counterparties to the derivatives transactions are Israeli banks, the Company considers the inherent credit risks remote.

### C. Foreign exchange risk management

The Group operates internationally, which gives rise to exposure to market risks mainly from changes in exchange rates of foreign currencies in relation to the functional currency.

From time to time, the Company enters into foreign currency forward transactions in order to protect itself against the risk that the eventual cash flows resulting from anticipated transactions (mainly from subscription fees to be received), denominated in currencies other than the functional currency, will be affected by changes in exchange rates. The Company has certain involvement with derivative financial instruments for trading purposes.

As of December 31, 2007 and 2006, the Company was not party to foreign currency derivatives that were designated and accounted as hedging instruments under FAS No. 133.

## NOTE 22 SUBSEQUENT EVENTS AFTER BALANCE SHEET DATE

See Note 12.D.2.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the shareholders of

**Iturán Argentina S.A.**

We have audited the balance sheets of Iturán Argentina S.A. (the Company) as of December 31, 2007 and 2006 and the related statements of operations, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States of America). 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 the Company's Board of Directors and 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2007 and 2006 and the results of operations, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

Buenos Aires, Argentina  
February 8, 2008

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Gustavo R. Chesta (Partner)

**Auditores Independentes**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the shareholders of Teleran Holding Ltda. Brazilian entity

We have audited the consolidated balance sheets of Teleran Holding Ltda. (the Company) and its subsidiaries as of December 31, 2007 and 2006 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, 2007. These financial statements are the responsibility of the Company's Board of Directors and management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the Brazilian generally accepted auditing standards, which are substantially equivalent to those established by the Public Company Accounting Oversight Board (United States of America). 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 the Company's Board of Directors and 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, 2007 and 2006 and the consolidated results of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

São Paulo, Brazil

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José André Viola Ferreira

June 27, 2008

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**SIGNATURES**

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

**ITURAN LOCATION AND CONTROL LTD.**  
(Registrant)

By: /s/ Eyal Sheratzky

/s/ Nir Sheratzky

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Eyal Sheratzky

\_\_\_\_\_  
Nir Sheratzky

Co-Chief Executive Officer

Dated: June 30, 2008