

SECURITY MATTERS LTD.

FINANCIAL STATEMENTS AS OF DECEMBER 31, 2017

SECURITY MATTERS LTD.

TABLE OF CONTENTS

	<u>Page</u>
Independent auditors' report	1-6
Statements of financial position	7-8
Statements of comprehensive income	9
Statements of changes in shareholders' equity	10
Statements of cash flows	11
Notes to financial statements	12-36

The amounts are stated in thousand U.S dollars

Independent Auditors' Statements to Shareholders of Security Matters Ltd.

Opinion

We have audited the accompanying financial statements of Security Matters Ltd. (the "Company"), which comprise the statements of financial position as at December 31, 2017, 2016 and 2015 and the related statements of comprehensive income, changes in equity (deficit) and cash flows for each of the three years then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2017, 2016 and 2015, and of its financial performance and its cash flows for each of the three years then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audits in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audits of the financial statements section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audits of the financial statements in Israel, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audits evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audits Matters

Key audits matters are those matters that, in our professional judgment, were of most significance in our audits of the financial statements of the current period. These matters were addressed in the context of our audits of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

<i>Share Based Compensation</i>	<i>How the matter was addressed in our audits</i>
Share based compensation for the year ended December 31, 2017 amounted to 720 thousand USD.	Our procedures in respect of this area included: <ul style="list-style-type: none">• We held discussions with key management personnel to understand the share based compensation schemes.

<p>The related disclosure appears in Note 11.B to the financial statements.</p> <p>The Company has a share based remuneration scheme for employees. The fair value of share options is estimated based on the Black & Scholes model valuation methodology which takes into account the terms and conditions upon which the options were granted. This calculation is a judgmental accounting area which requires assumptions utilized in the fair value calculations.</p>	<ul style="list-style-type: none"> • We read relevant documents related to the issuance of the options. • Our valuation team evaluate the calculation of the fair value and the report prepared by company's independent valuation expert. • Our valuation team examined the reasonability of the assumptions and the methodology which were the basis of the calculation. • We verified the inputs data of the calculations by reference to, where appropriate, external data. • We examined the reputation and the objectivity of the independent valuation expert. • We considered the adequacy of the Company's disclosures in respect of the treatment of the options in the financial statements, and over the disclosure on its accounting policies.
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<p><i>Capitalization of development costs as intangible assets and subsequent valuation</i></p>	<p><i>How the matter was addressed in our audits</i></p>
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<p>Capitalized development costs amounted to a net book value of 779, 393 and 69 thousands USD as of December 31, 2017, 2016 and 2015 respectively.</p> <p>The related disclosure appears in Note 6 to the financial statements.</p> <p>Development costs mainly comprise software development costs. The Company capitalizes costs upon meeting the criteria as described in IAS 38. Capitalization criteria assessment under IAS 38 requires significant judgment and measurement uncertainty at inception and throughout the life of the project.</p>	<p>Our procedures in respect of this area included:</p> <ul style="list-style-type: none"> • We assessed the eligibility of the development costs for capitalization as intangible asset under IAS 38. • We reviewed the methodology applied by the Company to identify the categories of intangible asset. • We reviewed the design of the controls identified by the management surrounding the intangible assets capitalization and subsequent measurement and which we considered key, tested such controls and performed substantive
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	<p>test of details on the capitalized development costs.</p> <ul style="list-style-type: none"> • Our valuation team evaluate the assumptions and methodologies used by the Company to test the impairment of these intangible assets. • Our valuation team have validated that the cash flow forecasts used in the valuation are consistent with information approved by the Board. • Our valuation team have challenged the key assumptions such as the discount rates by comparing them to relevant market rates and to verify that management had been consistent in its approach to valuations.
<i>Convertible loan at fair value</i>	<i>How the matter was addressed in our audits</i>
<p>Convertible loan at fair value amounted to a book value of 3,586 and 2,222 thousands USD as of December 31, 2017, and 2016 respectively</p> <p>The related disclosure appears in Note 9 to the financial statements.</p>	<p>Our procedures in respect of this area included:</p> <ul style="list-style-type: none"> • We held discussions with key management personnel to understand the convertible loan terms. • We read relevant documents related to the convertible loan. • Our valuation team evaluate the calculation of the fair value and the report prepared by company's independent valuation expert. • Our valuation team examined the reasonability of the assumptions and the methodology which were the basis of the calculation. • We verified the inputs data of the calculations by reference to, where appropriate, external data. • We examined the reputation and the objectivity of the independent valuation expert.

	<p>We considered the adequacy of the Company's disclosures in respect of the treatment of the convertible loan in the financial statements, and over the disclosure on its accounting policies.</p>
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Other information

The directors are responsible for the other information. The other information comprises the information contained in the directors' report for the years ended December 31, 2017, 2016 and 2015 but does not include the financial statements and our auditor's report thereon. Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audits of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audits or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the management and directors for the Financial Statements

The directors of the Company are responsible for the preparation and fair presentation of these financial statements in accordance with IFRSs, and for such internal control as management and the directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In preparing the financial statements, the management and the directors are responsible for assessing the ability of the Company to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the management and the directors either intend to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the Audits of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audits conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of the audits in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audits. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audits procedures responsive to those risks, and obtain audits evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audits in order to design audits procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audits evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audits evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audits and significant audits findings, including any significant deficiencies in internal control that we identify during our audits.

We also provide those charged with governance regarding with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with We also provide those charged with governance regarding with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our

independence, and where applicable, related safeguards., we determine those matters that were of most significance in the audits of the financial statements of the current period and are therefore the key audits matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Tel-Aviv, Israel

March 29, 2018

Ziv haft
Certified Public Accountants (Isr.)
BDO Member Firm



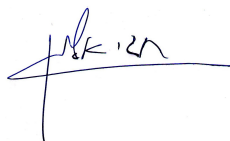
SECURITY MATTERS LTD.
STATEMENTS OF FINANCIAL POSITION
(US Dollar in thousands)

	<u>Note</u>	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>December 31, 2015</u>
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents		11	137	31
Bank deposit		-	-	146
Other account receivable	4	163	114	437
Total current assets		<u>174</u>	<u>251</u>	<u>614</u>
NON-CURRENT ASSETS:				
Property and equipment, net	5	360	394	98
Intangible assets, net	6	779	393	69
Total non-current assets		<u>1,139</u>	<u>787</u>	<u>167</u>
TOTAL ASSETS		<u><u>1,313</u></u>	<u><u>1,038</u></u>	<u><u>781</u></u>

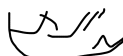
The accompanying notes are an integral part of the financial statements.

SECURITY MATTERS LTD.
STATEMENTS OF FINANCIAL POSITION
(US Dollar in thousands)

	Note	December 31, 2017	December 31, 2016	December 31, 2015
LIABILITIES AND EQUITY				
CURRENT LIABILITIES:				
Trade payables		391	324	58
Other accounts payable	7	352	101	59
Convertible loan at fair value	9	3,586	2,222	-
Current portion of loans from related parties	8	72	325	64
Total current liabilities		<u>4,401</u>	<u>2,972</u>	<u>181</u>
NON-CURRENT LIABILITIES:				
Loans from related parties	8	476	195	448
Other long term liabilities		95	77	32
Total non-current liabilities		<u>571</u>	<u>272</u>	<u>480</u>
EQUITY:				
	11			
Share capital		1,250	500	500
Capital reserve		720	-	-
Prepayments on account of shares		130	-	-
Retained earnings		(5,759)	(2,706)	(380)
Total equity		<u>(3,659)</u>	<u>(2,206)</u>	<u>120</u>
TOTAL LIABILITIES AND EQUITY		<u>1,313</u>	<u>1,038</u>	<u>781</u>



Haggai Alon
Chief Executive Officer



Yonatan Musnikow
Chief Financial Officer

March 29, 2018

Date of approval of the
Financial statements

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

SECURITY MATTERS LTD.
STATEMENTS OF COMPREHENSIVE INCOME
(US Dollar in thousands except loss per share)

	Note	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Revenue		6	-	-
Cost of revenues		<u>15</u>	<u>-</u>	<u>-</u>
Gross loss		9	-	-
Share based compensation	11	720	-	-
Research and development expenses	12	893	528	172
Impairment of property and equipment		-	683	-
General and administrative expenses	13	441	376	160
Selling and marketing expenses		<u>16</u>	<u>44</u>	<u>42</u>
Operating loss		2,079	1,631	374
Finance income		-	(3)	(1)
Finance expenses		<u>974</u>	<u>698</u>	<u>7</u>
Loss before tax		3,053	2,326	380
Taxes on income	14	<u>-</u>	<u>-</u>	<u>-</u>
Total comprehensive loss		<u><u>3,053</u></u>	<u><u>2,326</u></u>	<u><u>380</u></u>
 Basic and diluted loss per share *	 17	 <u><u>(0.034)</u></u>	 <u><u>(0.026)</u></u>	 <u><u>(0.005)</u></u>

* Retroactive effect to reflect the split occurred in 2018 – see note 19.

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

SECURITY MATTERS LTD.
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(US Dollar in thousands)

	<u>Share capital</u>	<u>Additional paid in capital</u>	<u>Capital reserve</u>	<u>Prepayments on account of shares</u>	<u>Accumulated deficit</u>	<u>Total</u>
Balance at January 1, 2015	-	-	-	-	-	-
Changes during the year:						
Issuance of shares upon inception	*	500	-	-	-	500
Total comprehensive loss	-	-	-	-	(380)	(380)
Balance at December 31, 2015	<u>*</u>	<u>500</u>	<u>-</u>	<u>-</u>	<u>(380)</u>	<u>120</u>
Changes during the year:						
Total comprehensive loss	-	-	-	-	(2,326)	(2,326)
Balance at December 31, 2016	<u>*</u>	<u>500</u>	<u>-</u>	<u>-</u>	<u>(2,706)</u>	<u>(2,206)</u>
Changes during the year:						
Issuance of shares	*	750	-	-	-	750
Share based compensation	-	-	720	-	-	720
Prepayments on account of shares	-	-	-	130	-	130
Total comprehensive loss	-	-	-	-	(3,053)	(3,053)
Balance at December 31, 2017	<u>*</u>	<u>1,250</u>	<u>720</u>	<u>130</u>	<u>(5,759)</u>	<u>(3,659)</u>

* Less than 1 thousand dollars

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

SECURITY MATTERS LTD.
STATEMENTS OF CASH FLOWS
(US Dollar in thousands)

	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss for the year	(3,053)	(2,326)	(380)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	61	12	4
Decrease (increase) in other account receivable	(49)	323	(437)
Share based compensation	720	-	-
Change in fair value of convertible loan	788	667	-
Increase in trade payables	67	266	58
Increase in other long term liabilities	18	45	32
Increase in other accounts payable	251	42	59
Impairment of property and equipment, net	-	683	-
Exchange rate differences on loans from related parties	56	8	-
Net cash used in operating activities	(1,141)	(280)	(664)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, plant and equipment	(14)	(991)	(102)
Change in bank deposit	-	146	(146)
Capitalized development costs	(399)	(324)	(69)
Net cash used in investing activities	(413)	(1,169)	(317)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Receipts (repayment) of long term loans from related parties	(28)	-	512
Receipts of convertible loan	576	1,555	-
Prepayments on account of shares	130	-	-
Issuance of shares, net	750	-	500
Net cash provided by financing activities	1,428	1,555	1,012
Net Increase (decrease) in cash and cash equivalents	(126)	106	31
Cash and cash equivalents at beginning of the year	137	31	-
Cash and cash equivalents at the end of the year	11	137	31

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

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 1 - GENERAL:

Security Matters Ltd. (the “Company”) was incorporated in August, 2014 and began its business activity during the year of 2015.

The Company provides one solution to solve many significant brand challenges; authenticity, supply chain management, brand accountability & quality assurance. The Company technology is a chemical-based hidden barcode system, alongside a unique “reader” to identify these codes.

The technology is valid for various industries, including but not limited to; electronics, plastic, chemicals & additives, polymers, minerals and precious stones, paints and coatings, 3D printing and seeds (agriculture).

The Company solutions can be embedded in the product during the manufacturing process or via its raw materials or applied to the final product.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES:

The significant accounting policies followed in the preparation of the financial information, on a consistent basis, are:

Basis of preparation

The principal accounting policies adopted in the preparation of the financial statements are set out below. The policies have been consistently applied to all the years presented, unless otherwise stated.

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The financial statements have been prepared under the historical cost convention. The Company has elected to present the statement of comprehensive income using the function of expense method.

Estimates and assumptions

The preparation of the financial statements requires management to make estimates and assumptions that have an effect on the application of the accounting policies and on the reported amounts of assets, liabilities and expenses. These estimates and underlying assumptions are reviewed regularly. Changes in accounting estimates are reported in the period of the change in estimate.

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.):

Foreign currency

The financial statements are prepared in US Dollars which is the functional currency.

Transactions and balances in foreign currencies are converted into US Dollars in accordance with the principles set forth by International Accounting Standard (IAS) 21 ("The Effects of Changes in Foreign Exchange Rates"). Accordingly, transactions and balances have been converted as follows:

- Monetary assets and liabilities – at the rate of exchange applicable at the consolidated statements of financial position date;
- Exchange gains and losses from the aforementioned conversion are recognized in the statement of comprehensive income.
- Expense items – at exchange rates applicable as of the date of recognition of those items.
- Non-monetary items are converted at the rate of exchange at the time of the transaction. Exchange gains and losses from the aforementioned conversions are recognized in the statement of comprehensive income.

Cash and cash equivalents

Cash equivalents are considered by the Company to be highly-liquid investments, including, inter alia, short-term deposits with banks and the maturity of which do not exceed three months at the time of deposit and which are not restricted.

Research and development

Research costs are expensed as incurred. Development expenditures on an individual project are recognized as an intangible asset when the Company can demonstrate:

- The product is technically and commercially feasible.
- The Company intend to complete the product so that it will be available for use or sale.
- The Company has the ability to use the product or sell it.
- The Company has the technical, financial and other resources to complete the development and to use or sell the product.
- The Company can demonstrate the probability that the product will generate future economic benefits.
- The Company is able to measure reliability the expenditure attributable to the product during the development.

Capitalized development costs are amortized on a straight line basis over their estimated useful lives of 5 years once the development is completed and the assets are in use. Subsequent expenditure on capitalized intangible assets is capitalized only where it clearly increases the economic benefits to be derived from the

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.):

Research and development (Cont.)

asset to which it relates. All other expenditure, including that incurred in order to maintain an intangible assets current level of performance, is expensed as incurred.

Earnings per share

Basic earnings per share are calculated as net loss attributed to the Company, divided by the weighted average number of ordinary shares, adjusted for any bonus element.

Governmental liabilities on grants received

The Company measured the fair value of its governmental liabilities on grants received, each period, based on discounted cash flows derived from Company's future anticipated revenues.

Fair value measurement

Fair value is the price that would be received when selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- A. In the principal market for the asset or liability; or
- B. In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible to the Company.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.):

Classification of financial instruments by fair value hierarchy

The financial instruments presented in the statements of financial position at fair value are grouped into classes with similar characteristics using the following fair value hierarchy which is determined based on the source of input used in measuring fair value:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable either directly or indirectly.
- Level 3 - Inputs that are not based on observable market data (valuation techniques which use inputs that are not based on observable market data).

Financial assets

The Company classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

Other current assets: These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise principally through the provision of goods and trade receivable, but also incorporate other types of contractual monetary asset. These assets are carried at amortized cost less any provision for impairment.

The Company has no financial assets classified at Fair value through profit or loss.

Financial liabilities

The Company classifies its financial liabilities as follows:

Other financial liabilities: Other financial liabilities include the following items:

- Trade payables, loans from related parties and other accounts payables are initially recognized at fair value less any transaction costs directly attributable to the issue of the instrument. Such interest-bearing liabilities are subsequently measured at amortized cost using the effective interest method, which ensures that any interest expense over the period is at a constant interest rate on the balance of the liability carried in the statement of financial position. Interest expense in this context includes initial transaction costs, as well as any interest or coupon payable while the liability is outstanding.
- Fair value through profit and loss: convertible loan is measured at fair value through profit or loss. Transaction costs are recognized in profit or loss.

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.):

Impairment of financial assets

The Company assesses at the end of each reporting period whether there is any objective evidence of impairment of a financial asset or group of financial assets as follows.

Financial assets carried at amortized cost:

There is objective evidence of impairment of loans and receivables if one or more events have occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows. Evidence of impairment may include indications that the debtor is experiencing financial difficulties, including liquidity difficulty and default in interest or principal payments.

Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

Recoverable amount is the higher of an asset's fair value less costs of disposal and value-in-use. The value-in-use is the present value of the estimated future cash flows relating to the asset using a pre-tax discount rate specific to the asset or cash-generating unit to which the asset belongs. Assets that do not have independent cash flows are grouped together to form a cash-generating unit.

In 2016, the Company recognized impairment of property and equipment, net (See also Note 5). During the years 2015 and 2017 no impairment charges of non-financial assets were recognized.

Property, plant and equipment

Items of property, plant and equipment are initially recognized at cost. Cost includes directly attributable costs and the estimated present value of any future costs of dismantling and removing items. Depreciation is computed by the straight line method, based on the estimated useful lives of the assets, as follows:

	<u>%</u>
Computers	33
Machines and equipment	20
Furniture and office equipment	10
Leasehold improvements	5

Leasehold improvements are depreciated over the term of the expected lease including optional extension, or the estimated useful lives of the improvements, whichever is shorter.

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.):

Employee benefits

The Company contributes towards the state pension in accordance with local legislation where required. The only obligation of the Company is to make the required contributions. Costs related to such contributions are expensed in the period in which they are incurred.

The Company has several employee benefit plans as to Israeli employees:

1. Short-term employee benefits: Short-term employee benefits include salaries, paid annual leave, paid sick leave, recreation and social security contributions and are recognized as expenses as the services are rendered. A liability in respect of a cash bonus or a profit-sharing plan is recognized when the Company has a legal or constructive obligation to make such payment as a result of past service rendered by an employee and a reliable estimate of the amount can be made.
2. Post-employment benefits: The plans are normally financed by contributions to insurance companies and classified as defined contribution plans or as defined benefit plans. The Company has defined for most of its employees contribution plans pursuant to Section 14 to the Severance Pay Law since 2004 under which the Company pays fixed contributions and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient amounts to pay all employee benefits relating to employee service in the current and prior periods.

Contributions to the defined contribution plan in respect of severance or retirement pay are recognized as an expense simultaneously with receiving the employee's services and no additional provision is required in the financial statements except for the unpaid contribution.

Intangible assets

Intangible assets include internally generated capitalized technology development costs. Intangible assets with a finite useful life are amortized over their estimated useful lives and reviewed for impairment whenever there is an indication that the asset may be impaired. The amortization period and the amortization method for an intangible asset are reviewed at least at each year end.

The carrying amount of these assets is reviewed whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. Expenditure incurred on development activities including the Company's software development is capitalized only where the expenditure will lead to new or substantially improved products, the products are technically and commercially feasible and the Company has sufficient resources to complete the development and reach the Stage for which the product is ready for use.

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.):

Intangible assets (Cont.)

Capitalized development costs are amortized on a straight line basis over their estimated useful lives of 5 years once the development is completed and the assets are in use and until such date it is tested for impairment test on a yearly basis. Subsequent expenditure on capitalized intangible assets is capitalized only where it clearly increases the economic benefits to be derived from the asset to which it relates. All other expenditure, including that incurred in order to maintain an intangible assets current level of performance, is expensed as incurred.

Share based compensation

The Company measures the share based listing expense and the cost of equity-settled transaction with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by using either the Binomial or Black-Scholes model taking into account the terms and conditions upon which the instruments were granted.

New accounting policies and disclosures

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative:

The amendments require entities to provide disclosure of changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Company has provided the information in note 10.

New IFRSs in the period prior to their adoption

IFRS 9 Financial Instruments:

IFRS 9 replaces the multiple classification and measurement models in IAS 39 Financial instruments: Recognition and measurement with a single model that has initially only two classification categories: amortized cost and fair value.

Classification of debt assets will be driven by the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. A debt instrument is measured at amortized cost if: a) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows, and b) the contractual cash flows under the instrument solely represent payments of principal and interest.

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.):

New IFRSs in the period prior to their adoption (Cont.)

All other debt and equity instruments, including investments in complex debt instruments and equity investments, must be recognized at fair value.

All fair value movements on financial assets are taken through the statement of profit or loss, except for equity investments that are not held for trading, which may be recorded in the statement of profit or loss or in reserves (without subsequent recycling to profit or loss).

For financial liabilities that are measured under the fair value option entities will need to recognize the part of the fair value change that is due to changes in the their own credit risk in other comprehensive income rather than profit or loss. The new standard also introduces expanded disclosure requirements and changes in presentation.

In December 2014, the IASB made further changes to the classification and measurement rules and also introduced a new impairment model. With these amendments, IFRS 9 is now complete. The changes introduce:

- a third measurement category (FVOCI) for certain financial assets that are debt instruments
- a new expected credit loss (ECL) model which involves a three-stage approach whereby financial assets move through the three stages as their credit quality changes. The stage dictates how an entity measures impairment losses and applies the effective interest rate method. A simplified approach is permitted for financial assets that do not have a significant financing component (e.g. trade receivables). On initial recognition, entities will record a day-1 loss equal to the 12 month ECL (or lifetime ECL for trade receivables), unless the assets are considered credit impaired.

IFRS 9 is to be applied for annual periods beginning on January 1, 2018.

IFRS 9 will not have a material impact on the financial statements.

IFRS 15 – "Revenue from Contracts with Customers" (hereafter – IFRS 15)

IFRS 15 shall replace other IFRS provisions relating to revenue recognition.

The core principle of IFRS 15 is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

IFRS 15 sets out a single revenue recognition model, according to which the entity shall recognize revenue in accordance with the said core principle by implementing a five-step model framework:

- 1) Identify the contract(s) with a customer.
- 2) Identify the performance obligations in the contract.

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.):

New IFRSs in the period prior to their adoption (cont.)

IFRS 15 – "Revenue from Contracts with Customers" (hereafter – IFRS 15) (Cont.)

- 3) Determine the transaction price.
- 4) Allocate the transaction price to the performance obligations in the contract.
- 5) Recognize revenue when the entity satisfies a performance obligation.

IFRS 15 provides guidance about various issues related to the application of the said model, including: recognition of revenue from variable consideration set in the contract, adjustment of the price of transaction set in the contract in order to reflect the effect of the time value of money and costs to obtain or fulfill a contract.

IFRS 15 extends the disclosure requirements regarding revenue and requires, among other things, that entities disclose qualitative and quantitative information about significant judgments made by management in determining the amount and timing of the revenue.

The standard shall be applied retrospectively for annual reporting periods starting on January 1, 2018 or thereafter, IFRS 15 will not have a material impact on the financial statements.

NOTE 3 - CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS:

Amortization of capitalized development costs and the useful life of property and equipment

Intangible assets and property and equipment are amortized or depreciated over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenue, which are periodically reviewed for continued appropriateness. Changes to estimates can result in significant variations in the amounts charged to the consolidated statement of comprehensive income in specific periods.

Share based compensation

The Company has a share based remuneration scheme for employees. The fair value of share options is estimated by using the a Black & Scholes model, which was derived to model the value of the firm's equity over time The simulation model was designed to take into account the unique terms and conditions of the performance shares and share options, as well as the capital structure of the firm and the volatility of its assets, on the date of grant based on certain assumptions. Those conditions are described in the share based compensation note and include, among others, the dividend growth rate, expected share price volatility and expected life of the options. The fair value of the equity settled options granted is charged to statement of comprehensive income over the vesting period of each tranche and the credit is taken to equity, based on the consolidated entity's estimate of shares that will eventually vest.

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 4 - OTHER ACCOUNT RECIVABLE:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Institutions	57	70	356
Related party	42	-	-
Prepaid expenses	4	3	4
Grant receivables	-	19	60
Other	60	22	17
Total	<u>163</u>	<u>114</u>	<u>437</u>

NOTE 5 - PROPERTY AND EQUIPMENT, NET:

	<u>Leasehold Improvements</u>	<u>Machines and Equipment</u>	<u>Furniture and Office Equipment</u>	<u>Computers</u>	<u>Total</u>
Cost					
At January 1, 2017	34	327	30	19	410
Additions	<u>3</u>	<u>4</u>	<u>-</u>	<u>7</u>	<u>14</u>
At December 31, 2017	37	331	30	26	424
Accumulated depreciation					
At January 1, 2017	2	2	4	8	16
Depreciation	<u>2</u>	<u>35</u>	<u>3</u>	<u>8</u>	<u>48</u>
At December 31, 2017	4	37	7	16	64
Net book value at December 31, 2017	<u>33</u>	<u>294</u>	<u>23</u>	<u>10</u>	<u>360</u>

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 5 - PROPERTY AND EQUIPMENT, NET (CONT.):

	<u>Leasehold Improvements</u>	<u>Machines and Equipment</u>	<u>Furniture and Office Equipment</u>	<u>Computers</u>	<u>Total</u>
Cost					
At January 1, 2016	34	28	30	10	102
Additions	-	982	-	9	991
Impairment	-	(683)	-	-	(683)
At December 31, 2016	<u>34</u>	<u>327</u>	<u>30</u>	<u>19</u>	<u>410</u>
Accumulated depreciation					
At January 1, 2016	1	-	1	2	4
Depreciation	<u>1</u>	<u>2</u>	<u>3</u>	<u>6</u>	<u>12</u>
At December 31, 2016	<u>2</u>	<u>2</u>	<u>4</u>	<u>8</u>	<u>16</u>
Net book value at December 31, 2016	<u>32</u>	<u>325</u>	<u>26</u>	<u>11</u>	<u>394</u>

	<u>Leasehold Improvements</u>	<u>Machines and Equipment</u>	<u>Furniture and Office Equipment</u>	<u>Computers</u>	<u>Total</u>
Cost					
At January 1, 2015	-	-	-	-	-
Additions	<u>34</u>	<u>28</u>	<u>30</u>	<u>10</u>	<u>102</u>
At December 31, 2015	<u>34</u>	<u>28</u>	<u>30</u>	<u>10</u>	<u>102</u>
Accumulated depreciation					
At January 1, 2015	-	-	-	-	-
Depreciation	<u>1</u>	<u>-</u>	<u>1</u>	<u>2</u>	<u>4</u>
At December 31, 2015	<u>1</u>	<u>-</u>	<u>1</u>	<u>2</u>	<u>4</u>
Net book value at December 31, 2015	<u>33</u>	<u>28</u>	<u>29</u>	<u>8</u>	<u>98</u>

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 6 - INTANGIBLE ASSETS, NET:

	<u>Internally generated capitalized development costs</u>		
	<u>Not Depreciated</u>	<u>Depreciated</u>	<u>Total</u>
Cost			
At January 1, 2017	342	51	393
Additions	<u>329</u>	<u>70</u>	<u>399</u>
At December 31, 2017	671	121	792
Accumulated depreciation			
At January 1, 2017	-	-	-
Amortization	<u>-</u>	<u>13</u>	<u>13</u>
At December 31, 2017			
Net book value at December 31, 2017	<u>671</u>	<u>108</u>	<u>779</u>

	<u>Internally generated capitalized development costs</u>		
	<u>Not Depreciated</u>	<u>Depreciated</u>	<u>Total</u>
Cost			
At January 1, 2016	69	-	69
Additions	<u>324</u>	<u>-</u>	<u>324</u>
At December 31, 2016	393	-	393
Accumulated depreciation			
At January 1, 2016	-	-	-
Amortization	<u>-</u>	<u>-</u>	<u>-</u>
At December 31, 2016			
Net book value at December 31, 2016	<u>393</u>	<u>-</u>	<u>393</u>

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 6 - INTANGIBLE ASSETS, NET (CONT.):

	<u>Internally generated capitalized development costs</u>		
	<u>Not Depreciated</u>	<u>Depreciated</u>	<u>Total</u>
Cost			
At January 1, 2015	-	-	-
Additions	69	-	69
At December 31, 2015	<u>69</u>	<u>-</u>	<u>69</u>
Accumulated depreciation			
At January 1, 2015	-	-	-
Amortization	-	-	-
At December 31, 2015	<u>-</u>	<u>-</u>	<u>-</u>
Net book value at December 31, 2015	<u>69</u>	<u>-</u>	<u>69</u>

NOTE 7 - OTHER ACCOUNTS PAYABLE:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Employees, salaries and related liabilities	200	66	29
Accrued expenses	79	9	19
Liabilities for grants received	39	19	-
Related party	29	7	11
Other	5	-	-
Total	<u>352</u>	<u>101</u>	<u>59</u>

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 8 - LOANS FROM RELATED PARTIES:

In 2015, the Company signed an agreement to receive a loan of NIS 2,000 Million from its major shareholders. The loan bears an interest at an annual rate of 4% and will be repaid in eight quarterly equal installments commencing December 31, 2016.

In December 2017, the Company reached an oral binding agreement with its shareholders according to which the loan will be repaid in eight equal quarterly installments commencing November 1, 2018. The amendment was put in writing during January 2018.

NOTE 9 - CONVERTIBLE LOAN AT FAIR VALUE:

In June 2016, the Company signed a convertible loan agreement (the "Convertible Loan Agreement") with a number of investors (the "Lenders"), in which the Company borrowed a total amount up to NIS 6 Million. On January 2, 2017 the Company received an additional amount of NIS 2 Million from a third party at the same terms. The convertible loan does not include any interest.

According to the Convertible Loan Agreement, the Lenders will convert their portion of the loan amount into capital shares at a price per share (hereafter "PPS"), equal to the lower of:

1. 30% discount of the lowest PPS paid in the equity capital as part of a qualified financing.
2. A PPS based on a Company pre-money valuation, on a fully diluted basis of \$25 Million.

Unless converted earlier, the loan amount may be converted into the most favorable class of shares at a PPS based on the Company's pre-money valuation, on a fully diluted basis of NIS 14 Million on September 30, 2017. At any time the loan cannot be repaid in cash.

On September 27, 2017, the conversion price date and terms changed according to the following:

1. Conversion date - changed from September 30, 2017 to March 31, 2018.
2. Conversion price - In case that the Company will complete an equity capital-financing round of at least \$1.5 Million according to Company pre-money valuation of \$18 Million, each of the Lenders will receive a discount rate of 35%-43% (varies depending on any further capital investment) of the lowest PPS paid in the equity capital-financing round.

The convertible loan were presented at fair value with changes on fair value recognize in statement of operations.

In March 2018, the loan was converted to equity – see note 19.

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 10 - FINANCING ACTIVITIES IN THE STATEMENT OF CASH FLOWS:

Reconciliation of the changes in liabilities for which cash flows have been, or will be classified as financing activities in the statement of cash flows:

	Loans from related parties
As of January 1, 2017	<u>520</u>
Changes from financing cash flows	
Repayment of loans	(28)
Total changes from financing cash flows	<u>(28)</u>
Exchange rate differences	56
As of December 31, 2017	<u>548</u>

	Convertible loan at fair value
As of January 1, 2017	<u>2,222</u>
Changes from financing cash flows	
Receipts of convertible loan	576
Total changes from financing cash flows	<u>576</u>
Change in fair value of convertible loan	788
As of December 31, 2017	<u>3,586</u>

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 11 - EQUITY:

A. Composed as follows as of December 31, 2017, 2016 and 2015

	Number of shares as of December 31, 2017	
	Authorized	Issued and outstanding
Ordinary shares of NIS 0.01 par value	10,100,000	91,889
	Number of shares as of December 31, 2016	
	Authorized	Issued and outstanding
Ordinary shares of NIS 0.01 par value	100,000	87,800
	Number of shares as of December 31, 2015	
	Authorized	Issued and outstanding
Ordinary shares of NIS 1 par value	1,000	878

Ordinary shares confer upon their holders the rights to receive notice to participate and vote in general meeting of the Company, and the right to receive dividends if declared.

- A. In January 2015 and upon inception, the Company signed an investment agreement (the "Agreement") according to which the Company will raise 500 in consideration of 176 ordinary shares of NIS 1 par value each. In addition, the Company issued 702 ordinary shares of NIS 1 par value to other investors with no consideration.
- B. In October 2016, the Company's shareholders approved a share split of the Company's shares, such that the par value of each ordinary share shall change from NIS 1 to NIS 0.01 and the Company's authorized share shall increase to 100,000 ordinary shares of par value NIS 0.01.
- C. In July 2017, the Company's shareholders approved the increase of the number of shares authorized from 100,000 to 10,100,000.
- D. In 2017 the Company issued 4,089 ordinary shares of NIS 0.01 par value to several shareholders and investors in consideration of a total amount of 750.
- E. As of December 31, 2017, the Company received 130 as prepayment on account of shares. The shares were issued in February 2018 (see also Note 19).

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 11 - EQUITY (CONT.):

B. Share based compensation

In 2017 the Company established a share option plan (the "Plan"). Under the Plan 6,759 options for ordinary shares have been granted to employees throughout 2017 and 1,350 options throughout 2018. The options have an exercise price per share of NIS 103, NIS 184, and \$186.

The vesting period varies between 2015 and 2017 for a period of 3 to 5 years which begins on the vesting commencement date. Contractual life of the options under the Plan is 10 years. The options were granted under section 102 to Israeli tax ordinance which enables the employee to pay 25% of capital gain tax upon exercise. According to the options grant agreements, the employees must provide services up to the vesting date of the options.

A summary of the status of the Company's option plan granted to employees as of December 31, 2017 and changes during the relevant period ended on that date is presented below:

	Year ended December 31, 2017	
	Number of options	Weighted average exercise price
Outstanding at beginning of year	-	-
Granted	6,759	\$ 35
Exercised	-	
Forfeited and cancelled	(963)	\$ 35
Outstanding at end of year	<u>5,796</u>	<u>\$ 35</u>
Exercisable options	<u>1,720</u>	<u>\$ 35</u>

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 12 - RESEARCH AND DEVELOPMENT EXPENSES:

	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Payroll and related expenses	682	266	48
Research expenses, net	83	145	50
Depreciation	48	12	4
Subcontractors	46	83	69
Rent	26	9	-
Travel expenses	8	13	1
Total	<u>893</u>	<u>528</u>	<u>172</u>

NOTE 13 - GENERAL AND ADMINISTRATIVE EXPENSES:

	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Professional services	238	208	80
Management fee	107	74	51
Payroll and related expenses	38	28	20
Travel expenses	28	22	3
Others	30	44	6
Total	<u>441</u>	<u>376</u>	<u>160</u>

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 14 - TAXES ON INCOME:

Taxes on income:

Israeli corporate tax rates are 24% in 2017, 25% in 2016 and 26.5% in 2015.

The Law for the Amendment to the Income Tax Ordinance, New Version, 1961(hereafter – "the Ordinance") (Amendment 216 to the Ordinance) (hereafter – "the amendment") was published in the official gazette in January 2016; the said law stipulated the reduction of the rate of corporate tax from 26.5% to 25% commencing January 1, 2016. On December 2016, the Israeli government published the Economic Efficiency Law (2016) (legislative amendments to accomplish budget goals for the years 2017 and 2018) According to which, in 2017 the tax rate will decrease by 1% and starting 2018 by 2%; so that the tax rate will be 24% in 2017 and 23% in 2018 and onwards. Since the Company has carry forward losses and there are no deferred tax assets or liabilities there is no impact of the tax rate change.

Net operating losses carry forwards:

As of December 31, 2017, the Company has estimated carry forward tax losses of approximately 4,693 which may be carried forward and offset against taxable income for an indefinite period in the future. The Company did not recognized deferred tax assets relating to carry forward losses in the financial statements because their utilization in the foreseeable future is not probable.

Theoretical tax:

	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Loss before taxation	(3,017)	(2,326)	(380)
Theoretical tax credit at applicable statutory 2017: 24% ,2016: 25%, 2015: 26.5%	724	581	101
Non allowable expenses	(35)	(24)	(18)
Tax losses for which no DTA is recognized	(689)	(557)	(83)
Income tax benefit	<u>-</u>	<u>-</u>	<u>-</u>

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 15 - RELATED PARTIES:

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party's making of financial or operational decisions, or if both parties are controlled by the same third party. The Company has transactions with key officers, directors and shareholders.

The following transactions arose with related parties:

Related party transactions

	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Salary to related parties	273	74	51
Interest expenses on loan to related party	24	20	5

Liabilities to related party

Name	Nature of transaction	December 31, 2017	December 31, 2016	December 31, 2015
Related parties	Convertible loan	288	260	-
Related parties	Liabilities to related parties	548	520	512
Related parties	Ongoing transaction	29	7	11

Assets to related party

Name	Nature of transaction	December 31, 2017	December 31, 2016	December 31, 2015
Related parties	Other account receivable	42	-	-

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 16 - COMMITMENTS AND CONTINGENT LIABILITIES:

1. As part of the Board's ongoing regulatory compliance process, the Board continues to monitor legal and regulatory developments and their potential impact on the Company. Management is not aware of any contingencies that may have a significant impact on the financial position of the Company.
2. The Company leases its offices and Laboratory under an operating lease agreement. The total future value of minimum lease payments is due as follows:

	December 31, 2017	December 31, 2016	December 31, 2015
Not later than one year	18	18	4
Later than one year and not later five years	4	20	37
	<u>22</u>	<u>38</u>	<u>41</u>

3. The Company participates in programs sponsored by the OCS, for the support of research and development projects. In exchange for the Chief Scientist's participation in the programs, the Company is required to pay royalties to the Chief Scientist at a rate between 3% and 3.5% of sales to end customers of products developed with funds provided by the Chief Scientist, if and when such sales are recognized. As long as the Company continues to meet the criteria for receiving these grants, then the Company is not required to repay the grants. If the Company ceases to meet these and other criteria, then the grant amounting for the year in which the Company ceased to meet the criteria become immediately due and payable to OCS. As of December 31, 2017, the Company has received grants amounted to 160. As of December 31, 2017, 2016 and 2015, the Company recognized a liability to the OCS in the amount of 114, 92 and 31, respectively. The exceptions of the Company to pay the grants are based on its estimation at the end of the each year. The discounted rate used by the Company for the liability is 23.7%.

NOTE 17 - LOSS PER SHARE:

Loss per share have been calculated using the weighted average number of shares in issue during the relevant financial periods, the weighted average number of equity shares in issue and loss for the period as follows:

	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Loss for the year attributed to shareholders	3,053	2,326	380
Weighted average number of ordinary shares*	89,682,060	87,800,000	74,569,863
Basic and diluted loss per share	<u>(0.034)</u>	<u>(0.026)</u>	<u>(0.005)</u>

* See note 19

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 18 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT:

The Company is exposed to a variety of financial risks, which results from its financing, operating and investing activities. The objective of financial risk management is to contain, where appropriate, exposures in these financial risks to limit any negative impact on the Company's financial performance and position. The Company's financial instruments are its cash and other receivables, payables and other payables. The main purpose of these financial instruments is to raise finance for the Company's operation. The Company actively measures, monitors and manages its financial risk exposures by various functions pursuant to the segregation of duties and principals. The risks arising from the Company's financial instruments are mainly credit risk and currency risk. The risk management policies employed by the Company to manage these risks are discussed below.

Credit risk

Credit risk arises when a failure by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date. The Company closely monitors the activities of its counterparties and controls the access to its intellectual property which enables it to ensure the prompt collection of customer's balances. The Company's main financial assets are cash and cash equivalents as well as other receivables and represent the Company's maximum exposure to credit risk in connection with its financial assets. Wherever possible and commercially practical the Company holds cash with major financial institutions in Israel.

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	December 31, 2017	December 31, 2016	December 31, 2015
Cash and cash equivalents	11	137	31
Other account receivable	109	111	419
Bank deposit	-	-	146
Total	<u>120</u>	<u>248</u>	<u>596</u>

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 18 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONT.):

Currency risk

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. Currency risk arises when future commercial transactions and recognized assets and liabilities are denominated in a currency that is not the Company's functional currency. The Company is exposed to foreign exchange risk arising from various currency exposures primarily with respect to the New Israeli Shekel ("NIS"). The Company's policy is not to enter into any currency hedging transactions.

The carrying amounts of the Company's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	December 31, 2017		
	Assets	Liabilities	Total
NIS	119	(4,914)	(4,795)

	December 31, 2016		
	Assets	Liabilities	Total
NIS	156	(3,191)	(3,035)

	December 31, 2015		
	Assets	Liabilities	Total
NIS	596	(662)	(66)

Sensitivity analysis

A 10% strengthening of the United States Dollar against the following currencies would have increased (decreased) equity and the income statement by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. For a 10% weakening of the United States Dollar against the relevant currency, there would be an equal and opposite impact on the profit and other equity.

	December 31, 2017	December 31, 2016	December 31, 2015
Linked to NIS	(4,795)	(3,035)	(66)
	10%	10%	10%
	(479)	(304)	(7)

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 18 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONT.):

Liquidity risks

Liquidity risk is the risk that arises when the maturity of assets and the maturity of liabilities do not match. An unmatched position potentially enhances profitability, but can also increase the risk of loss. The Company has procedures with the object of minimizing such loss by maintaining sufficient cash and other highly liquid current assets and by having available an adequate amount of committed credit facilities. Accordingly, the Company has a positive working capital.

The following tables detail the Company's remaining contractual maturity for its financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to pay.

	Up to 3	Between	Between	Between	
	Months	3 and 12	1 and 2	2 and 5	Over
At December 31, 2017		months	year	years	5 years
Trade payables	391	-	-	-	-
Other accounts payable	330	22	-	-	-
Other long term liabilities	-	-	53	38	-
Loan from related party	-	72	476	-	-
Convertible loan at fair value	-	3,586	-	-	-
Total	721	3,680	529	38	-

	Up to 3	Between	Between	Between	
	Months	3 and 12	1 and 2	2 and 5	Over
At December 31, 2016		months	year	years	5 years
Trade payables	324	-	-	-	-
Other accounts payable	84	17	-	-	-
Other long term liabilities	-	-	-	74	-
Loan from related party	-	325	195	-	-
Convertible loan at fair value	-	2,222	-	-	-
Total	408	2,564	195	74	-

SECURITY MATTERS LTD.
NOTES TO FINANCIAL STATEMENTS
(US Dollar in thousands)

NOTE 18 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONT.):

Liquidity risks (Cont.)

	Up to 3	Between	Between	Between	Over
At December 31, 2015	Months	3 and 12	1 and 2	2 and 5	5 years
	Months	months	year	years	5 years
Trade payables	58	-	-	-	-
Other accounts payable	59	-	-	-	-
Other long term liabilities	-	-	-	32	-
Loans from related parties	-	64	448	-	-
Total	117	64	448	32	-

Operational risk

Operational risk is the risk that derives from the deficiencies relating to the Company's information technology and control systems as well as the risk of human error and natural disasters. The Company's systems are evaluated, maintained and upgraded continuously.

NOTE 19 – SUBSEQUENT EVENTS:

1. On February 2018, the Company raised capital of 750 by of issuance of 4,023 shares. The investors were current shareholders of the Company, which invested according to the same terms at which they invested in the share purchase agreement from July 2017. This investment completed a capital raise of 1.5 million by the Company.
2. In February 2018, the Company completed the investment round of 1.5 Million, which led to the conversion of all of the convertible loan to shares. The Company issued to the investors in the bridge finance loan agreement a total of 17,553 shares.
3. In March 2018, the shareholders and board of the Company allocated 9,645 shares from the Company authorized shares, equal to 8.5% of Company issued shares, for a pool of employee shares option plan, as a preparation for the initial public offering.
4. In March 2018, the Company's shareholders approved a share split of the Company's shares, such that the par value of each ordinary share shall change from NIS 0.01 to NIS 0.00001 and the Company's authorized share shall increase to 10,100,000,000 ordinary shares of par value NIS 0.00001.