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TASTY BAKING CO  
Form 10-Q  
May 05, 2005

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON D.C. 20549

FORM 10-Q

(Mark One)

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

For the thirteen weeks ended March 26, 2005

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-5084

TASTY BAKING COMPANY  
(Exact name of company as specified in its charter)

Pennsylvania  
(State of Incorporation)

23-1145880  
(IRS Employer Identification Number)

2801 Hunting Park Avenue, Philadelphia, Pennsylvania 19129  
(Address of Principal Executive Offices) (Zip Code)

(215) 221-8500  
(Company's Telephone Number, including area code)

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

Yes X No \_\_\_

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes X No \_\_\_

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, par value \$.50	8,161,698
(Title of Class)	(No. of Shares Outstanding as of March 26, 2005)

TASTY BAKING COMPANY AND SUBSIDIARIES

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Part I. FINANCIAL INFORMATION  
Item 1. Financial Statements

TASTY BAKING COMPANY AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)  
(000's)

	March 26, 2005	December
<b>Assets</b>		
<b>Current assets:</b>		
Cash	\$ 247	\$
Receivables, less allowance of \$5,581 and \$4,848, respectively	22,607	20,
Inventories	5,759	5,
Deferred income taxes	3,367	3,
Prepayments and other	1,140	1,
<b>Total current assets</b>	<b>33,120</b>	<b>30,</b>
<b>Property, plant and equipment:</b>		
Land	1,033	1,
Buildings and improvements	41,249	41,
Machinery and equipment	139,967	166,
	182,249	208,
Less accumulated depreciation	118,751	143,
	63,498	65,
<b>Other assets:</b>		
Long-term receivables from independent sales distributors	11,514	11,
Deferred income taxes	10,337	10,
Other	1,767	1,
	23,618	23,
<b>Total assets</b>	<b>\$120,236</b>	<b>\$118,</b>
<b>Liabilities</b>		
<b>Current liabilities:</b>		
Current obligations under capital leases	\$ 720	\$
Notes payable, banks	6,800	2,
Accounts payable	7,550	9,
Accrued payroll and employee benefits	7,103	7,
Reserve for restructures	568	
Other	1,847	3,
<b>Total current liabilities</b>	<b>24,588</b>	<b>23,</b>
Long-term obligations under capital leases, less current portion	3,974	4,
Long-term debt	10,000	9,
Reserve for restructures, less current portion	283	
Accrued pensions and other liabilities	23,893	23,
Postretirement benefits other than pensions	16,674	16,
<b>Total liabilities</b>	<b>79,412</b>	<b>77,</b>

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Shareholders' equity		
Common stock	4,558	4,
Capital in excess of par value of stock	29,281	29,
Retained earnings	22,331	22,
	-----	
	56,170	56,
Less:		
Accumulated other comprehensive loss	2,398	2,
Treasury stock, at cost	12,873	12,
Management Stock Purchase Plan receivables and deferrals	75	
	-----	
	40,824	40,
	-----	
Total liabilities and shareholders' equity	\$120,236	\$118,
	=====	

See Notes to Consolidated Financial Statements.

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TASTY BAKING COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)  
(000's, except per share amounts)

	For the Thirteen Weeks Ended	
	March 26, 2005	March 27, 2004 (a)
	-----	-----
Gross Sales	\$ 65,946	\$ 68,360
Less discounts and allowances	(24,792)	(27,882)
	-----	-----
Net Sales	41,154	40,478
	-----	-----
Costs and expenses:		
Cost of sales	26,024	26,325
Depreciation	1,801	1,730
Selling, general and administrative	12,654	11,577
Interest expense	321	303
Other income, net	(238)	(226)
	-----	-----
	40,562	39,709
	-----	-----
Income before provision for income taxes	592	769
Provision for income taxes	113	286
	-----	-----
Net income	\$ 479	\$ 483

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=====		
Average common shares outstanding:		
Basic	8,064	8,096
Diluted	8,167	8,113
Per share of common stock:		
Net income:		
Basic and Diluted	\$ 0.06	\$ 0.06
	=====	=====
Cash dividend	\$ 0.05	\$ 0.05
	=====	=====

(a) Amounts have been reclassified for comparative purposes.

See Notes to Consolidated Financial Statements.

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TASTY BAKING COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOW  
(Unaudited)  
(000's)

	-----	
	For the Thirteen Weeks Ended	
	March 26, 2005	March 27, 2004
	-----	
Cash flows from (used for) operating activities		
Net income	\$ 479	\$ 483
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,801	1,730
Restructure payments	(186)	(528)
Pension expense	84	527
Deferred taxes	(87)	--
Other	264	89
Changes in assets and liabilities:		
Increase in receivables	(2,778)	(1,002)
Increase in inventories	(347)	(122)
Increase in prepayments and other	(24)	(359)
Decrease in accounts payable, accrued payroll and other current liabilities	(3,036)	(91)

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Net cash from (used for) operating activities	(3,830)	727
Cash flows from (used for) investing activities		
Purchase of property, plant and equipment	(392)	(2,148)
Proceeds from independent sales distributor loan repayments	1,814	741
Loans to independent sales distributors	(2,142)	(573)
Other	1	9
Net cash used for investing activities	(719)	(1,971)
Cash flows from (used for) financing activities		
Dividends paid	(409)	(405)
Payment of long-term debt	(177)	(155)
Net increase (decrease) in short-term debt	4,100	(200)
Additional long-term debt	1,000	2,000
Purchase of treasury stock	(38)	--
Net cash from financing activities	4,476	1,240
Net decrease in cash	(73)	(4)
Cash, beginning of year	320	33
Cash, end of period	\$ 247	\$ 29
Supplemental Cash Flow Information Cash paid (refunded) during the period for:		
Interest	\$ 320	\$ 325
Income taxes	\$ (47)	\$ 7

See Notes to Consolidated Financial Statements.

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### 1. Significant Accounting Policies

#### Nature of the Business

Tasty Baking Company is a leading producer of sweet baked goods and one of the nation's oldest and largest independent baking companies, in operation since 1914. It has two manufacturing facilities, one in Philadelphia, PA, and a second facility in Oxford, PA.

#### Fiscal Year

The company and its subsidiaries operate on a 52-53 week fiscal year, ending on the last Saturday of December. Fiscal year 2005 is a 53-week year.

#### Basis of Consolidation

The consolidated financial statements include the accounts of the company and its subsidiaries. Inter-company transactions are eliminated.

#### Interim Financial Information

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting only of normal and recurring adjustments, necessary to present fairly the financial position of the company as of March 26, 2005 and December 25, 2004, the results of its operations for the thirteen weeks ended March 26, 2005 and March 27, 2004, and cash flows for the thirteen week period ended March 26, 2005 and March 27, 2004, respectively. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto in the company's 2004 Annual Report to Shareholders. In addition, the results of operations for the thirteen weeks ended March 26, 2005 are not necessarily indicative of the results to be expected for the full year.

#### Use of Estimates

Certain amounts included in the accompanying consolidated financial statements and related footnotes reflect the use of estimates based on assumptions made by management. These estimates are made using all information available to management, and management believes that these estimates are as accurate as possible as of the dates and for the periods that the financial statements are presented. Actual amounts could differ from these estimates. Significant estimates for the company include receivable's allowance, inventory reserves, reserve for product returns, and pension plan assumptions for plan asset return and discount rate.

#### Revenue Recognition

Revenue is recognized when title and risk of loss pass, which is generally upon receipt of goods by the customer. For route area sales, the company sells to independent sales distributors who, in turn, sell to retail customers. Provisions for estimated discounts, product returns and other adjustments are provided in the same period that the related sales are recorded based upon promotional calendars and historical trends.

#### Cash and Cash Equivalents

The company considers all investments with an original maturity of three months or less on their acquisition date to be cash equivalents.

#### Inventory Valuation

Inventories are stated at the lower of cost or market, cost being determined using the first-in, first-out ("FIFO") method.

#### Property and Depreciation

Property, plant and equipment are carried at cost. Depreciation is computed by the straight-line method over the estimated useful lives of the assets. Buildings and improvements are depreciated over thirty-nine years. The principal manufacturing plant is leased from the company's pension plan and is amortized over twenty years. Leasehold improvements are generally depreciated over thirty-nine years. Machinery and equipment are depreciated over a range of seven to fifteen years. Spare parts are capitalized as part of machinery and equipment and are expensed as utilized. The new enterprise resource planning system is being depreciated over five years.

Costs of major additions, replacements and betterments are capitalized, while maintenance and repairs, which do not improve or extend the life of the respective assets, are expensed as incurred.

The company capitalizes interest and labor costs associated with the construction and installation of plant and equipment and significant information technology development projects.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If this review indicates that the expected future undiscounted net cash flows of the related asset is less than the asset's carrying value, an impairment loss is recognized.

#### Pension Plan

The company's funding policy for the pension plan ("Pension Plan") is to contribute amounts deductible for federal income tax purposes plus such additional amounts, if any, as the company's actuarial consultants advise to be appropriate. In 1987 the company elected to immediately recognize all gains and losses in excess of the pension corridor.

The company accrues normal periodic pension expense or income during the year based upon certain assumptions and estimates from its actuarial consultants in accordance with Statement of Financial Accounting Standard No. 87, "Employers' Accounting for Pensions." These estimates and assumptions include discount rate, rate of return on plan assets, compensation increases, mortality and employee turnover. In addition, the rate of return on plan assets is directly related to changes in the equity and credit markets, which can be very volatile. The use of the above estimates and assumptions, market volatility and the company's election to immediately recognize all gains and losses in excess of its pension corridor in the current year may cause the company to experience significant changes in its pension expense or income from year to year. Expenses or income that fall outside the corridor are recognized only in the fourth quarter of each year.



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The company amended the Pension Plan to freeze benefit accruals effective March 26, 2005. Participants will be credited for service after March 26, 2005 solely for vesting purposes pursuant to the terms of the Pension Plan. Each vested participant will receive their total pension benefit accrued through March 26, 2005, upon retirement from the company.

Effective March 27, 2005 the company adopted a new company funded retirement plan, which is a defined contribution benefit that replaces the benefit provided in the Pension Plan. In the new company funded retirement plan, the company will make cash contributions into individual accounts for eligible employees. These contributions will be equal to a percentage of an employee's eligible compensation and will increase with the employee's age and years of credited service.

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### Stock-Based Compensation

In December of 2002, the Financial Accounting Standards Board (FASB) issued Statement No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure - an Amendment of FASB Statement No. 123 (FAS 148)." The provisions of this statement are effective for fiscal years beginning after December 15, 2003. The company measures stock-based compensation and reports the calculated differences between the reported and pro-forma impact of the fair-value method on the interim and annual financial reports as required. See Recent Accounting Statements regarding a change effective in 2006.

	Thirteen Weeks Ended	
	March 26, 2005	March 27, 2004
	-----	-----
Net income as reported	\$ 479	\$ 483
Deduct: Total stock-based employee compensation expense determined under fair-value net of related tax effects	(62)	(61)
Pro forma net income	\$ 417	\$ 422
Earnings per share:		
Basic and Diluted - as reported	\$ 0.06	\$ 0.06
Basic and Diluted - pro forma	\$ 0.05	\$ 0.05

### Treasury Stock

Treasury stock is stated at cost. Cost is determined by the FIFO method.

### Net Income Per Common Share

Net income per common share is presented as basic and diluted earnings

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per share. Net income per common share - Basic is based on the weighted average number of common shares outstanding during the year. Net income per common share - Diluted is based on the weighted average number of common shares and dilutive potential common shares outstanding during the year. Dilution is the result of including outstanding stock options and restricted shares.

### Recent Accounting Statements

In December 2004, the FASB issued FASB Statement No. 123(R), Share-Based Payment (FAS 123(R)), which requires companies to expense the fair-value of employee stock options and other forms of stock-based compensation. In April 2005, the SEC approved a new rule that makes FAS 123(R) effective for annual periods that begin after June 15, 2005. The company expects to adopt FAS 123(R) in January 2006. The company expects to select the Modified Prospective Application (MPA), without restatement of prior interim periods in the year of adoption. The company is currently evaluating the impact of the adoption of this standard, but does not expect a material impact compared to the pro forma amounts.

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### 2. Restructure Charges

In the fourth quarter 2004, the company settled certain thrift store lease contracts for a gain of \$35. The gain was offset by reversals of previously settled contracts, and other adjustments related to the estimated expenses for maintaining the thrift stores still under contract, which resulted in a net charge of \$9.

The company recognized net restructure charge reversal in 2003 of \$500. These reversals resulted from favorable settlements of certain thrift store lease contracts reversal in the 2002 restructuring.

During the fourth quarter of 2003, the company incurred a \$429 pre-tax restructure charge related to specific arrangements made with senior executives who departed the company.

During the fourth quarter of 2002, the company incurred a \$4,936 pre-tax restructure charge related to the closing of twelve thrift stores and the specific arrangements made with senior executives who departed the company in the fourth quarter of 2002. There were 29 employees terminated as a result of this restructure, of which 25 were thrift store employees and 4 were corporate executives.

During the second quarter of 2002, the company closed six thrift stores and eliminated certain manufacturing and administrative positions. There were 67 employees terminated as a result of this restructure, of which 42 were temporary employees, 13 were thrift store employees and 12 were corporate and administrative employees. Costs related to these events were included in a pre-tax restructure charge of \$1,405.

During the fourth quarter of 2001, the company closed its Dutch Mill Baking Company production facility. In addition, the company closed two thrift stores. Costs related to these events were included in a pre-tax restructure charge of \$1,728.

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### Restructure Reserve Activity

	Lease obligations	Severance	Other	T
	-----	-----	-----	-----
Balance December 27, 2003	\$ 813	\$ 1,485	\$ 77	\$ 2
Q1 2004 Payments	(125)	(387)	(16)	
	-----	-----	-----	-----
Balance March 27, 2004	688	1,098	61	1
Q2 2004 Payments	(112)	(187)	(16)	
	-----	-----	-----	-----
Balance June 26, 2004	576	911	45	1
Q3 2004 Payments	(88)	(176)	(16)	
	-----	-----	-----	-----
Balance September 25, 2004	488	735	29	1
Q4 2004 Reversal of reserve, net of adjustments	4	-	5	
Q4 2004 Payments	(85)	(143)	4	
	-----	-----	-----	-----
Balance December 25, 2004	407	592	38	1
Q1 2005 Payments	(116)	(58)	(12)	
	-----	-----	-----	-----
Balance March 26, 2005	\$ 291	\$ 534	\$ 26	\$
	=====	=====	=====	=====

The balance of the severance charges is expected to be paid as of December 2005 and the balance of the lease obligations and other charges is expected to be paid as of November 2006.

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### 3. Inventories

Inventories are classified as follows:

	March 26, 2005	Decembe
	-----	-----
Finished goods	\$ 1,550	\$
Work in progress	175	
Raw materials and supplies	4,034	
	-----	-----
	\$ 5,759	\$
	=====	=====

### 4. Credit Facility

On January 31, 2002, the company entered into a new \$40 million Credit Facility (Facility) with two banks (the Bank Group) to replace its short-term lines of credit and the former Revolving Credit Agreement. The agreement was subsequently amended on January 23, 2004 to reduce the commitments under the Facility to \$30 million. The Facility, as amended,

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provides \$10 million for short-term borrowings under a 364-day line and \$20 million for long-term borrowings under a three year revolving line. The 364-day line contains a \$6 million sub-limit for overnight borrowings and the revolving line allows for the issuance of Standby Letters of Credit up to \$6 million, which reduce the availability under the Facility. Upon approval of the Bank Group, the terms of both the 364-day line and the revolving line may be extended for an additional 364-day or annual period, respectively. Interest rates in the Facility are indexed to LIBOR or the Prime Rate based upon the company's ratio of debt to EBITDA and rates may change up to 1.5% based on that ratio. Commitment fees are charged on the unused portion of the Facility and range from 30 to 45 basis points based upon the same ratio used to determine interest rates. The Facility, as amended, contains restrictive covenants that require the maintenance of minimum Tangible Net Worth, that limit the amount of capital expenditures and that limit the ratios of EBITDA to certain fixed charges and total indebtedness. The Facility also provides the Bank Group with a security interest in all unencumbered assets of the company including certain real property through the second quarter of 2005. After that date, the security interest may be terminated if certain objective measures are met.

In the first quarter of 2005, the company and the Bank Group amended the Facility 1) to waive certain covenant violations that existed on December 25, 2004; 2) to amend the Facility's definitions to exclude the effects of the company's 2004 pension expense in excess of its 10% corridor; 3) to amend the limit on capital expenditures for 2005 to \$10 million; 4) to amend the minimum Tangible Net Worth required; and 5) to extend the maturity of the 364-day line to March 20, 2006. The waivers obtained cured the company's covenant violations for its 2004 capital expenditures and its required minimum Tangible Net Worth.

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### 5. Defined Benefit Retirement Plans

The company maintains a partially funded noncontributory Pension Plan providing retirement benefits for substantially all employees. Benefits under this Pension Plan generally are based on the employees' years of service and compensation during the years preceding retirement. The company maintains an unfunded Supplemental Executive Retirement Plan ("SERP") providing retirement benefits for key employees designated by the Board of Directors. Benefits under the SERP generally are based on the key employees' years of service and compensation during the years preceding retirement. The company also maintains an unfunded Directors' Retirement Plan. The benefit amount is the annual retainer in the year of retirement.

In December 2004, upon approval by the Board of Directors, the company announced to its employees that it was amending the Pension Plan to freeze benefit accruals effective March 26, 2005. Participants will be credited for service after March 26, 2005, solely for vesting purposes pursuant to the terms of the Pension Plan. Each vested participant will receive their total pension benefit accrued through March 26, 2005, upon retirement from the company.

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Effective at the beginning of the second quarter 2005, the company adopted a new company funded retirement plan which is a defined contribution benefit that replaces the benefit provided in the Pension Plan. In the new company funded retirement plan, the company will make cash contributions into individual accounts for all eligible employees. These contributions will be equal to a percentage of an employee's eligible compensation and will increase with the employee's age and years of credited service.

Effective October 2004, the SERP for all active employees was converted from a defined benefit to a defined contribution plan to be consistent with the changes made to the Pension Plan.

The components of the Pension, SERP, and Directors' Retirement plans are summarized as follows:

		Thirteen W March 26, 2005
Service cost	\$	131
Interest cost		1,209
Expected return on plan assets		(1,266)
Amortization of prior service costs		(4)
Amortization of net loss		14
		-----
Net pension amount charged to income	\$	84
		=====

There is no minimum cash contribution to the Pension Plan in 2005. The company is expecting to make a cash contribution in 2005 but has not determined the amount.

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### 6. Postretirement Benefits Other than Pensions

Components of Net Periodic Postretirement Benefit Cost:

		Thirteen W March 26, 2005
Service cost	\$	97
Interest cost		202
Net amortization and deferral (a)		(105)
		-----
Net periodic benefit cost	\$	194
		=====

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- (a) Reflects an estimate of changes in the cost of postretirement life insurance to retirees. Amounts shown assume that the changes will reduce the company's share of this cost by approximately 34%.

### Employer Contributions:

Estimated company contributions for the thirteen weeks ended March 26, 2005, are \$309.

The Medicare Prescription Drug Improvement and Modernization Act of 2003 was signed into law on December 8, 2003. In accordance with FASB Staff Position FAS 106-1, the company has made a one-time election to defer recognition of the effects of the law in the accounting for its plan under FAS 106 and in providing disclosures related to the plan. In accordance with FASB Staff Position 106-2, any measures of the Accumulated Postretirement Benefit Obligation or Net Periodic Postretirement Benefit Cost do not reflect any amount associated with the subsidy because the company has not yet concluded whether the benefits provided by the plan are actuarially equivalent to Medicare Part D under the Act.

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### TASTY BAKING COMPANY AND SUBSIDIARIES (000's, except share and per share amounts)

#### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

-----

#### Results of Operations

##### Overview

Net income for the first quarter of 2005 was \$479 or \$.06 per diluted share. Net income for the first quarter of 2004 was \$483 or \$.06 per diluted share.

##### Sales

Net sales increased by 1.7% in the first quarter of 2005 compared to the same quarter in 2004. Gross sales decreased 3.5% in the first quarter versus the same quarter a year ago driven by a 3.6% sales volume decline. This decline in gross sales was offset by a decrease of 11.1% in discounts and allowances for the first quarter 2005 versus 2004. The decline in discounts and allowances was driven by lower promotional expense year-over-year due to higher promoted price points in the route geographies. In addition, the cost of product returns decreased for route sales.

Route net sales were up 1.1% in the first quarter 2005 versus 2004, driven primarily by the lower promotional expense, as mentioned above, and an increase in sales from the Tastykake Sensables product line, which launched in the third

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quarter 2004. These improvements were partially offset by a decline in Family Pack volume due to the higher promoted price points in the first quarter 2005 versus the first quarter a year ago. Non-route net sales were up 3.8% for the first quarter 2005 compared to the same period in 2004 due to an increase in sales to certain existing direct sales customers.

### Cost of Sales

Cost of sales, excluding depreciation, for the first quarter of 2005 decreased by 1.1%. This decrease in cost of sales dollars was driven by the 3.6% sales volume decline in the first quarter 2005 compared to 2004. This decrease was partially offset by significant increases in utility expenses in the first quarter 2005 compared to same quarter a year ago. As a percentage of gross sales, cost of sales increased 1.0 percentage point to 39.5% in the first quarter 2005 from 38.5% in the first quarter of 2004.

### Gross Margin

Gross margin after depreciation, was 32.4% of net sales for the first quarter of 2005 compared to 30.7% in the first quarter 2004. The 1.7 percentage point improvement resulted from the improved price realization on net sales, partially offset by the cost of sales increases.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the first quarter of 2005 increased \$1,077, or 9.3%, compared to the first quarter in 2004. This change is attributed to increased investment in the sales and information technology organizations, as well as increased marketing expense compared to last year. The increase was also attributed to consultant costs incurred to assist with the completion of internal control testing required by Section 404 of the Sarbanes-Oxley Act of 2002, as amended. In addition, there were higher consulting costs associated with enhanced Enterprise Resource Planning support in the month of January 2005. These increases were partially offset by a first quarter reduction in pension expense during the conversion of the defined benefit pension plan to a defined contribution pension plan.

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### Depreciation

Depreciation expense in the first quarter of 2005 increased 4.1% compared to the same period a year ago. This is a result of the increase in depreciation from the new Enterprise Resource Planning system implemented in the fourth quarter of 2004, partially offset by assets related to the previous Enterprise Resource Planning system that became fully depreciated at the end of 2004.

### Non-Operating Items

Interest expense increased by \$19 or 6.2%, in the first quarter of 2005 compared to the first quarter of 2004. This is due to increased average interest rates, partially offset by a decrease in the average borrowing levels in the first quarter 2005 versus the same period a year ago. The company is exposed to market risk relative to its interest expense as its notes payable and long-term debt have floating interest rates that vary with the conditions in the credit market. It is expected that a one percentage point increase in interest rates would

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result in additional quarterly expense of approximately \$40, pre-tax.

The effective income tax rate was 19.0% and 37.2% for the thirteen weeks ended March 26, 2005 and March 27, 2004, respectively. These rates compare to a federal statutory rate of 34%. In 2005, the difference between the effective rate and the statutory rate is the result of estimated state tax benefits generated from state tax losses as well as state and federal tax credits and adjustments related to prior year estimates. In 2004, the difference between the effective tax rate and the statutory tax rate is principally due to the effect of state income taxes. For the balance of 2005, the company expects an effective income tax rate of 34.0%.

### Liquidity and Capital Resources

Current assets at March 26, 2005 were \$33,120 compared to \$30,153 at December 25, 2004, and current liabilities at March 26, 2005, were \$24,588 compared to \$23,384 at December 25, 2004. The increase in current assets is primarily related to a seasonal increase in accounts receivable, net of the allowance. The accounts receivable allowance increased by \$733 which can be attributed to a reserve for customer credits not yet issued for certain promotional deals. The increase in current liabilities in the first quarter of 2005 was principally related to an increase in short term notes payable, partially offset by a decrease in accounts payable and other accrued expenses.

Historically, the company has been able to generate sufficient amounts of cash from operations. Bank borrowings are used to supplement cash flow from operations during periods of cyclical shortages. A Credit Facility is maintained with two banks and certain capital and operating leases are utilized.

On January 31, 2002, the company entered into a new \$40 million Credit Facility (Facility) with two banks (the Bank Group) to replace its short-term lines of credit and the former Revolving Credit Agreement. The agreement was subsequently amended on January 23, 2004 to reduce the commitments under the Facility to \$30 million. The Facility, as amended, provides \$10 million for short-term borrowings under a 364-day line and \$20 million for long-term borrowings under a three year revolving line. The 364-day line contains a \$6 million sub-limit for overnight borrowings and the revolving line allows for the issuance of Standby Letters of Credit up to \$6 million, which reduce the availability under the Facility. Upon approval of the Bank Group, the terms of both the 364-day line and the revolving line may be extended for an additional 364-day or annual period, respectively. Interest rates in the Facility are indexed to LIBOR or the Prime Rate based upon the company's ratio of debt to EBITDA and rates may change up to 1.5% based on that ratio. Commitment fees are charged on the unused portion of the Facility and range from 30 to 45 basis points based upon the same ratio used to determine interest rates. The Facility, as amended, contains restrictive covenants that require the maintenance of minimum Tangible Net Worth, that limit the amount of capital expenditures and that limit the ratios of EBITDA to certain fixed charges and total indebtedness. The Facility also provides the Bank Group with a security interest in all unencumbered assets of the company including certain real property through the second quarter of 2005. After that date, the security interest may be terminated if certain objective measures are met.

In the first quarter of 2005, the company and the Bank Group amended the



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Facility 1) to waive certain covenant violations that existed on December 25, 2004; 2) to amend the Facility's definitions to exclude the effects of the company's 2004 pension expense in excess of its 10% corridor; 3) to amend the limit on capital expenditures for 2005 to \$10 million; 4) to amend the minimum Tangible Net Worth required; and 5) to extend the maturity of the 364-day line to March 20, 2006. The waivers obtained cured the company's covenant violations for its 2004 capital expenditures and its required minimum Tangible Net Worth.

Net cash from operating activities for the thirteen weeks ended March 26, 2005 decreased by \$4,557 compared to the same period in 2004. This decrease was driven by an unfavorable change in assets and liabilities in the first quarter of 2005 compared to the change in first quarter of 2004. The unfavorable change in assets and liabilities resulted from an increase in accounts receivable that was greater than the increase in the prior year. There was also a significant decrease in accounts payable that was larger than the decrease during the comparable period last year. Non-cash adjustments decreased for the thirteen weeks ended March 26, 2005 compared to the same period in 2004. This was partially offset by lower cash restructure payments in the first quarter of 2005 compared to the same period in 2004.

Net cash used for investing activities for the thirteen weeks ended March 26, 2005 decreased by \$1,252 relative to the same period in 2004. In the first quarter of 2005, there was a \$1,756 decrease in capital expenditures relative to the prior year. During the first quarter in 2004, the company began the implementation of its new Enterprise Resource Planning system. Partially offsetting this decrease in capital expenditures was an increase of \$496 in the net expenditures for financing activity to the independent sales distributors relative to the same period last year, which is due to the timing of settlements for independent sales distributor financing.

Net cash from financing activities for the thirteen weeks ended March 26, 2005 increased by \$3,236 relative to the comparable period in 2004 due primarily to a \$4,300 increase in the short-term borrowing position offset by a \$1,000 decrease in additional long-term debt.

For the remainder of 2005, the company anticipates that cash flow from operations, along with the continued availability of credit under the Amended Facility, will provide sufficient cash to meet operating and financing requirements.

### Forward-Looking Statements

Certain matters discussed in this Report, including those under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations," contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, and are subject to the safe harbor created by that Act. These forward-looking statements can be identified by the use of such words as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "predict," "project," "should," "would," "is likely to," or "is expected to" and other similar terms. They include comments about competition in the baking industry, concentration of customers, commodity prices, consumer preferences, long-term receivables, inability to develop brand recognition in the company's expanded market, production and inventory concerns, loss of one or both of the company's production facilities, availability of capital, fluctuation in interest rates, governmental regulations, legal proceedings, pension expense, protection of the company's intellectual property and trade secrets and other statements contained herein that are not historical facts. Because such forward-looking statements involve risks and uncertainties, various factors could cause actual results to differ materially from those expressed or implied by such forward-looking statements, including, but not limited to, changes in general economic or business conditions nationally and in the company's primary markets, the availability of capital upon terms acceptable

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to the company, the availability and prices of raw materials, the level of demand for the company's products, the outcome of legal proceedings to which the company is or may become a party, the actions of competitors within the packaged food industry, changes in consumer tastes or eating habits, the success of business strategies implemented by the company to meet future challenges, and the ability to develop and market in a timely and efficient manner new products which are accepted by consumers. The reader should review "Management's Discussion and Analysis" and "Risk Factors" in the company's 2004 Annual Report to Shareholders and in the company's annual report on Form 10-K for the year ended December 25, 2004, for a more complete discussion of other risk factors which may affect the company's financial position or operating performance.

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### Item 3. Quantitative and Qualitative Disclosures about Market Risk

The company is exposed to market risk relative to its interest expense as its notes payable and long-term debt have floating interest rates that vary with the conditions in the credit markets and the company's financial performance. It is expected that a one percentage point increase in interest rates would result in additional quarterly expense of approximately \$40. Under current market conditions, the company believes that changes in interest rates would not have a material impact on the financial statements of the company. The company also has notes receivable from independent sales distributors whose rates adjust every three years, which would partially offset the fluctuations in the company's interest rates on its notes payable. The company also has the right to sell these notes receivable, and could use these proceeds to liquidate a corresponding amount of the notes payable. For a more detailed explanation see the company's 2004 Annual Report on Form 10-K "Quantitative and Qualitative Disclosure about Market Risk," page 16.

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### Item 4. Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

The company maintains a system of disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in the company's reports filed or submitted pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission ("SEC"). Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to the company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

The company carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Chief

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Financial Officer, of the design and operation of the company's disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the company's Chief Executive Officer and Chief Financial Officer concluded that the company's disclosure controls and procedures were not effective at March 26, 2005 because of the material weaknesses in internal control over financial reporting related to accounting for income taxes and payroll as fully described in our Annual Report on Form 10-K for the year ended December 25, 2004.

We performed additional analysis and other post-closing procedures to provide assurances that our Consolidated Financial Statements are prepared in accordance with generally accepted accounting principles. Accordingly, management believes that the financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

### (b) Changes in Internal Control over Financial Reporting

The company has made changes in its internal control over financial reporting during the period covered by this report that have materially affected the company's internal control over financial reporting. In particular, the company implemented the following enhancements to its internal control over financial reporting related to the material weaknesses described in the company's Form 10-K for the year ended December 25, 2004:

1. Accounting for Income Taxes: The company has i) implemented additional monitoring controls through increased documented management review; ii) fully documented the methodology and tools for calculating and reporting tax related transactions; iii) enhanced the formality and rigor of controls for reconciliation procedures; and iv) increased use of a third party service provider for the more complex areas of the company's income tax compliance efforts. The enhancements have not been in place for a sufficient length of time to allow management to obtain a large enough sample size to complete remediation testing on these controls. Nevertheless, the enhancements have allowed us to maintain a reasonable level of assurance regarding the amount of taxes recorded in this report.
2. Payroll: Effective March 2005, the company made improvements to segregation of duties and formalized and implemented more rigorous approval policies and procedures. The enhancements have not been in place for a sufficient length of time to allow management to obtain a large enough sample size to complete remediation testing on these controls. Nevertheless, the enhancements have allowed us to maintain a reasonable level of assurance regarding payroll expenses and liabilities recorded in this report.
3. Spare Parts Inventory: During the first quarter of 2005, the company formalized and enhanced management's process for documenting and executing cycle counts, performing analytical procedures surrounding parts issues, and assuring authorization of price and use of parts on a monthly basis. These enhancements have been in place long enough for management to obtain a large enough sample size to complete remediation testing. Remediation testing evidenced that these controls

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give the company a reasonable level of assurance that expenses and assets related to spare parts are properly reflected in this report.

There were no additional changes in the period covered by this report that materially affected, or are reasonably likely to materially affect, the company's internal control over financial reporting.

### Item 5. Other Information

The company's definitive proxy statement for the 2005 Annual Meeting of Shareholders (filed with the SEC on April 8, 2005) incorrectly reported that 283,106 shares of common stock were available for future grants under the 2003 Long Term Incentive Plan as of December 25, 2004. The actual number of shares available was 4,894. Accordingly, the second paragraph on page 19 of the definitive proxy statement should now read as follows: "As of December 25, 2004, the 2003 Long Term Incentive Plan had 4,894 shares of common stock available for future grants of stock options, restricted stock and other awards under the Plan."

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### TASTY BAKING COMPANY AND SUBSIDIARIES

#### PART II. OTHER INFORMATION

#### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

##### Issuer Purchases of Equity Securities

On July 28, 2004, the Board of Directors renewed the company's stock repurchase program originally adopted in July 2003. Under the program, the company may acquire up to 400,000 shares of Tasty Baking Company common stock, which is approximately 5% of the shares outstanding, through July 29, 2006. These purchases may be commenced or suspended without prior notice depending on then-existing business or market conditions and other factors. The following chart sets forth the amounts of the company's common stock purchased on the open market by the company during the first quarter of fiscal 2005 under the stock repurchase plan.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maxi Approximate Shares (or yet be pur Plans
December 26 - January 29	-	-	-	388,6
January 30- February 26	-	-	-	388,6
February 27- March 26	4,500	\$8.43	4,500	384,1
Total	4,500	\$8.43	4,500	384,1

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Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 3 - Bylaws of company, amended March 22, 2005 are incorporated herein by reference to Exhibit 3(b) to Form 10-K for the fiscal year ended December 25, 2004.

Exhibit 10.1 - Sixth Amendment to Credit Agreement, dated January 21, 2005, by and among the company and PNC Bank, N.A. and Citizens Bank of Pennsylvania is incorporated herein by reference to Exhibit 10(r) to Form 10-K for the fiscal year ended December 25, 2004.

Exhibit 10.2 -Waiver and Seventh Amendment to Credit Agreement, dated February 28, 2005, by and among the company and PNC Bank, N.A. and Citizens Bank of Pennsylvania is incorporated herein by reference to Exhibit 10(s) to Form 10-K for the fiscal year ended December 25, 2004.

Exhibit 10.3 - Eighth Amendment to the Credit Agreement, dated March 21, 2005, by and among the company and PNC Bank, N.A. and Citizens Bank of Pennsylvania is incorporated herein by reference to Exhibit 10(t) to Form 10-K for the fiscal year ended December 25, 2004

Exhibit 31.1 - Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 - Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32 - Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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TASTY BAKING COMPANY AND SUBSIDIARIES

SIGNATURE

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Pursuant to the requirements of the Securities Exchange Act of 1934, the company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TASTY BAKING COMPANY

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(Company)

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May 5, 2005

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(Date)

/s/ David S. Marberger

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DAVID S. MARBERGER  
SENIOR VICE PRESIDENT AND  
CHIEF FINANCIAL OFFICER  
(Principal Financial and  
Accounting Officer)

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scontinued operations (746) (2,575) (623) - -	Total comprehensive loss for the	
year (2,865) (3,826) (1,628) (1,207) (1,257)	Loss for the year attributable to:	Equity
holders of the Company (2,527) (2,476) (1,390) (1,207) (1,257)	Non-controlling	
interests (338) (1,237) (352) - -	(2,865) (3,713) (1,742) (1,207) (1,257)	Total
comprehensive loss for the year attributable to:	Equity holders of the	
Company (2,527) (2,589) (1,276) (1,207) (1,257)	Non-controlling	
interests (338) (1,237) (352) - -	(2,865) (3,826) (1,628) (1,207) (1,257)	Basic and
diluted loss from continuing and discontinued operations (in US dollars)	From continuing	
operations (0.009) (0.005) (0.005) (0.006) (0.011)	From discontinued	
operations (0.002) (0.006) (0.001) - -	Basic and diluted loss per share	
(in US dollars) (0.011) (0.011) (0.006) (0.006) (0.011)	Weighted average number of issued ordinary	
shares 231,224,512 223,605,181 217,689,926 201,825,645 113,397,846		

Consolidated Statements of Financial Position Data:

	Year ended December 31,				
	2014	2013	2012	2011	2010
	U.S Dollars in thousands				
Cash, cash equivalents and bank deposits	2,159	4,165	3,312	1,495	1,066
Working capital	2,102	3,870	2,143	955	259
Total assets	5,644	8,015	11,086	4,073	3,797
Long term liabilities	-	11	13	-	-
Total shareholders' equity	4,660	6,265	7,353	3,444	2,834
Non-controlling interests	19	520	2,071	-	-

**B. Capitalization And Indebtedness**

Not applicable.

**C. Reasons For Offer And Use Of Proceeds**

Not applicable.

**D. Risk Factors**

*Before you invest in our ordinary shares or American Depositary Shares, you should understand the high degree of risk involved. You should carefully consider the risks described below and other information in this report, including our financial statements and related notes included elsewhere in this report, before you decide to purchase our ordinary shares or ADSs. If any of the following risks actually occur, our business, financial condition and operating results could be adversely affected. As a result, the trading price of our ordinary shares or ADSs could decline and you could lose part or all of your investment.*

**Risks Related to Our Business**

*We have incurred substantial operating losses since our inception. We expect to continue to incur losses in the future in our drug development activity and may incur losses in our medical device activity and may never become profitable.*

You should consider our prospects in light of the risks and difficulties frequently encountered by development stage companies. We have incurred operating losses since our inception and expect to continue to incur operating losses for the foreseeable future. As of December 31, 2014, we had an accumulated accounting deficit of approximately \$148 million. We have not yet commercialized any of our drug candidates or technologies and cannot be sure we will ever be able to do so. Even if we commercialize one or more of our drug candidates or technologies, we may not become profitable. Our ability to achieve profitability depends on a number of factors, including our ability to complete our development efforts, consummate out-licensing agreements, obtain regulatory approval for our drug candidates and technologies and successfully commercialize them.

*If our competitors develop and market products that are less expensive, more effective or safer than our products, our revenues and results may be harmed and our commercial opportunities may be reduced or eliminated.*

The pharmaceutical industry is highly competitive. Our commercial opportunities may be reduced or eliminated if our competitors develop and market products that are less expensive, more effective or safer than our products. Other companies have drug candidates in various stages of pre-clinical or clinical development to treat diseases for which we are also seeking to discover and develop drug candidates. Some of these potential competing drugs are already commercialized or are further advanced in development than our drug candidates and may be commercialized earlier. Even if we are successful in developing safe, effective drugs, our products may not compete successfully with products produced by our competitors, who may be able to market their drugs more effectively.



Our competitors include pharmaceutical companies and biotechnology companies, as well as universities and public and private research institutions. In addition, companies that are active in different but related fields present substantial competition for us. Many of our competitors have significantly greater capital resources, larger research and development staffs and facilities and greater experience in drug development, regulation, manufacturing and marketing than we do. These organizations also compete with us to recruit qualified personnel, attract partners for joint ventures or other collaborations, and license technologies that are competitive with ours. As a result, our competitors may be able to more easily develop products that could render our technologies or our drug candidates obsolete or noncompetitive. Development of new drugs, medical technologies and competitive medical devices may damage the demand for our products without any certainty that we will successfully and effectively contend with those competitors.

***If we lose our key personnel or are unable to attract and retain additional personnel, our business could be harmed.***

As of the date hereof, XTL had three full-time employees and two part-time service providers (one of whom is an officer).

To successfully develop our drug candidates and technologies, we must be able to attract and retain highly skilled personnel, including consultants and employees. The retention of their services cannot be guaranteed.

Our failure to retain and/or recruit such professionals might impair our performance and materially affect our technological and product development capabilities and our product marketing ability.

***Any acquisitions or in-licensing transactions we make may dilute your equity or require a significant amount of our available cash and may not be scientifically or commercially successful.***

As part of our business strategy, we may effect acquisitions or in-licensing transactions to obtain additional businesses, products, technologies, capabilities and personnel. If we complete one or more such transactions in which the consideration includes our ordinary shares or other securities, your equity may be significantly diluted. If we complete one or more such transactions in which the consideration includes cash, we may be required to use a substantial portion of our available cash.

Acquisitions and in-licensing transactions also involve a number of operational risks, including:

- difficulty and expense of assimilating the operations, technology or personnel of the business;
- our inability to attract and retain management, key personnel and other employees necessary to conduct the business;
- our inability to maintain relationships with key third parties, such as alliance partners, associated with the business;
- exposure to legal claims for activities of the business prior to the acquisition;

- the diversion of our management's attention from our other drug development and medical device businesses; and
- the potential impairment of substantial goodwill and write-off of in-process research and development costs, adversely affecting our reported results of operations.

In addition, the basis for completing the acquisition or in-licensing could prove to be unsuccessful as the drugs or processes involved could fail to be scientifically or commercially viable. We may also be required to pay third parties substantial transaction fees, in the form of cash or ordinary shares, in connection with such transactions.

If any of these risks occur, it could have an adverse effect on both the business we acquire or in-license and our existing operations.

***We face product liability risks and may not be able to obtain adequate insurance.***

The use of our drug candidates and technologies in clinical trials, and the sale of any approved products (drugs or medical devices), exposes us to liability claims. If we cannot successfully defend ourselves against product liability claims, we may incur substantial liabilities or be required to cease clinical trials of our drug candidates and technologies or limit commercialization of any approved products.

We believe that we will be able to obtain sufficient product liability insurance coverage for our planned clinical trials. We intend to expand our insurance coverage to include the commercial sale of any approved products if marketing approval is obtained; however, insurance coverage is becoming increasingly expensive. We may not be able to maintain insurance coverage at a reasonable cost. We may not be able to obtain additional insurance coverage that will be adequate to cover product liability risks that may arise. Regardless of merit or eventual outcome, product liability claims may result in:

decreased demand for a product;

damage to our reputation;

inability to continue to develop a drug candidate or technology;

withdrawal of clinical trial volunteers; and

loss of revenues.

Consequently, a product liability claim or product recall may result in material losses.

**Risks related to our drug development business**

***If we are unable to successfully complete our clinical trial programs for our drug candidates, or if such clinical trials take longer to complete than we project, our ability to execute our current business strategy will be adversely affected.***

Whether or not and how quickly we complete clinical trials depends in part upon the rate at which we are able to engage clinical trial sites and, thereafter, the rate of enrollment of patients, and the rate at which we are able to collect, clean, lock and analyze the clinical trial database. Patient enrollment is a function of many factors, including the size of the patient population, the proximity of patients to clinical sites, the eligibility criteria for the study, the existence of competitive clinical trials, and whether existing or new drugs are approved for the indication we are studying. We are aware that other companies are planning clinical trials that will seek to enroll patients with the same diseases and stages as we are studying. If we experience delays in identifying and contracting with sites and/or in patient enrollment in our clinical trial programs, we may incur additional costs and delays in our development programs, and may not be able to complete our clinical trials on a cost-effective or timely basis.

*If third parties on which we will have to rely for clinical trials do not perform as contractually required or as we expect, we may not be able to obtain regulatory approval for or commercialize our products.*

We will have to depend on independent clinical investigators, and other third-party service providers to conduct the clinical trials of our drug candidates and technologies. We also may, from time to time, engage a clinical research organization for the execution of our clinical trials. We will rely heavily on these parties for successful execution of our clinical trials, but we will not control many aspects of their activities. Nonetheless, we are responsible for confirming that each of our clinical trials is conducted in accordance with the general investigational plan and protocol. Our reliance on these third parties that we do not control does not relieve us of our responsibility to comply with the regulations and standards of the Food and Drug Administration (“FDA”) and/or other foreign regulatory agencies/authorities relating to good clinical practices. Third parties may not complete activities on schedule or may not conduct our clinical trials in accordance with regulatory requirements or the applicable trial’s plans and protocols. The failure of these third parties to carry out their obligations could delay or prevent the development, approval and commercialization of our products, or could result in enforcement action against us.

*Our international clinical trials may be delayed or otherwise adversely impacted by social, political and economic factors affecting the particular foreign country.*

We may conduct clinical trials in different geographical locations. Our ability to successfully initiate, enroll and complete a clinical trial in any of these countries, or in any future foreign country in which we may initiate a clinical trial, are subject to numerous risks unique to conducting business in foreign countries, including:

- difficulty in establishing or managing relationships with clinical research organizations and physicians;
- different standards for the conduct of clinical trials and/or health care reimbursement;
- our inability to locate qualified local consultants, physicians, and partners;

· the potential burden of complying with a variety of foreign laws, medical standards and regulatory requirements, including the regulation of pharmaceutical products and treatment; and

· general geopolitical risks, such as political and economic instability, and changes in diplomatic and trade relations.

Any disruption to our international clinical trial program could significantly delay our product development efforts.

*If the clinical data related to our drug candidates and technologies do not confirm positive early clinical data or preclinical data, our corporate strategy and financial results will be adversely impacted.*

Our drug candidates and technologies are in clinical stages. Specifically, our lead product candidates, hCDR1 and Recombinant Human Erythropoietin (rHuEPO) are each planned for and/or ready for a Phase 2 clinical study. In order for our candidates to proceed to later stage clinical testing or marketing approval, they must show positive clinical.

Preliminary results of pre-clinical, clinical observations or clinical tests do not necessarily predict the final results, and promising results in pre-clinical, clinical observations or early clinical testing might not be obtained in later clinical trials. Drug candidates in the later stages of clinical development may fail to show the desired safety and efficacy traits despite having progressed through initial clinical testing. Any negative results from future tests may prevent us from proceeding to later stage clinical testing or marketing approval, which would materially impact our corporate strategy, and our financial results may be adversely impacted.

***We have limited experience in conducting and managing clinical trials necessary to obtain regulatory approvals. If our drug candidates and technologies do not receive the necessary regulatory approvals, we will be unable to commercialize our products.***

We have not received, and may never receive, regulatory approval for commercial sale for hCDR1, rHuEPO or SAM-101. We currently do not have any drug candidates pending approval with the FDA or with regulatory authorities of other countries. We will need to conduct significant additional research and human testing before we can apply for product approval with the FDA or with regulatory authorities of other countries. In order to obtain FDA approval to market a new drug product, we or our potential partners must demonstrate proof of safety and efficacy in humans. To meet these requirements, we and/or our potential partners will have to conduct “adequate and well-controlled” clinical trials.

Clinical development is a long, expensive and uncertain process. Clinical trials are very difficult to design and implement, in part because they are subject to rigorous regulatory requirements. Satisfaction of regulatory requirements typically depends on the nature, complexity and novelty of the product and requires the expenditure of substantial resources. The commencement and rate of completion of clinical trials may be delayed by many factors, including:

- obtaining regulatory approvals to commence a clinical trial;

reaching agreement on acceptable terms with prospective CROs, and trial sites, the terms of which can be subject to extensive negotiation and may vary significantly among different CROs and trial sites;

· slower than expected rates of patient recruitment due to narrow screening requirements and competing clinical studies;

- the inability of patients to meet protocol requirements imposed by the FDA or other regulatory authorities;

- the need or desire to modify our manufacturing process;

delays, suspension, or termination of the clinical trials due to the institutional review board responsible for overseeing the study at a particular study site; and

- governmental or regulatory delays or “clinical holds” requiring suspension or termination of the trials.

Following the completion of a clinical trial, regulators may not interpret data obtained from pre-clinical and clinical tests of our drug candidates and technologies the same way that we do, which could delay, limit or prevent our receipt of regulatory approval. In addition, the designs of any clinical trials may not be reviewed or approved by the FDA prior to their commencement, and consequently the FDA could determine that the parameters of any studies are insufficient to demonstrate proof of safety and efficacy in humans. Failure to approve a completed study could also result from several other factors, including unforeseen safety issues, the determination of dosing, low rates of patient recruitment, the inability to monitor patients adequately during or after treatment, the inability or unwillingness of medical investigators to follow our clinical protocols, and the lack of effectiveness of the trials.

Additionally, the regulators could determine that the studies indicate the drugs may have serious side effects. In the US, this is called a black box warning, which is a type of warning that appears on the package insert for prescription drugs indicating that they may cause serious adverse effects. A black box warning means that medical studies indicate that the drug carries a significant risk of serious or even life-threatening adverse effects.

If the clinical trials fail to satisfy the criteria required, the FDA and/or other regulatory agencies/authorities may request additional information, including additional clinical data, before approval of marketing a product. Negative or inconclusive results or medical events during a clinical trial could also cause us to delay or terminate our development efforts. If we experience delays in the testing or approval process, or if we need to perform more or larger clinical trials than originally planned, our financial results and the commercial prospects for our drug candidates and technologies may be materially impaired.



Clinical trials have a high risk of failure. A number of companies in the pharmaceutical industry, including biotechnology companies, have suffered significant setbacks in clinical trials, even after achieving promising results in earlier trials. It may take us many years to complete the testing of our drug candidates and technologies, and failure can occur at any stage of this process.

Even if regulatory approval is obtained, our products and their manufacture will be subject to continual review, and there can be no assurance that such approval will not be subsequently withdrawn or restricted. Changes in applicable legislation or regulatory policies, or discovery of problems with the products or their manufacture, may result in the imposition of regulatory restrictions, including withdrawal of the product from the market, or result in increased costs to us.

***Because all of our proprietary drug candidates and technologies are licensed to us by third parties, termination of these license agreements could prevent us from developing our drug candidates.***

We do not own any of our drug candidates and technologies. We have licensed the rights, patent or otherwise, to our drug candidates from third parties. We have licensed hCDR1, a phase 2 clinical stage asset for the treatment of Systemic Lupus Erythematosus (“SLE”) from Yeda Research and Development Company Ltd. (“Yeda”). We licensed a use patent for the use of Recombinant Human Erythropoietin (rHuEPO) for the prolongation of Multiple Myeloma patients’ survival and improvement of their quality of life from Bio-Gal Ltd., or Bio-Gal, who in turn licensed it from Mor Research Applications Ltd., an Israeli corporation and licensing arm of Kupat Holim Clalit, one of the largest HMOs in Israel (“Mor”) and Yeda. We have licensed a patent on SAM-101 for the treatment of psychotic disorders from MinoGuard Ltd., or MinoGuard, who in turn licensed it from Mor.

These license agreements require us to meet development or financing milestones and impose development and commercialization due diligence requirements on us. In addition, under these agreements, we must pay royalties on sales of products resulting from licensed drugs and technologies and pay the patent filing, prosecution and maintenance costs related to the licenses. While we have the right to defend patent rights related to our licensed drug candidates and technologies, we are not obligated to do so. In the event that we decide to defend our licensed patent rights, we will be obligated to cover all of the expenses associated with that effort. If we do not meet our obligations in a timely manner, or if we otherwise breach the terms of our agreements, our licensors could terminate the agreements, and we would lose the rights to our drug candidates and technologies. From time to time, in the ordinary course of business, we may have disagreements with our licensors or collaborators regarding the terms of our agreements or ownership of proprietary rights, which could lead to delays in the research, development, collaboration and commercialization of our drug candidates, or could require or result in litigation or arbitration, which could be time-consuming and expensive.

***If we do not establish or maintain drug development and marketing arrangements with third parties, we may be unable to commercialize our drug candidates and technologies into products.***

We are an emerging company and do not possess all of the capabilities to fully commercialize our drug candidates and technologies on our own. From time to time, we may need to contract with third parties to:

- assist us in developing, testing and obtaining regulatory approval for some of our compounds and technologies;
- manufacture our drug candidates; and
- market and distribute our products.

We can provide no assurance that we will be able to successfully enter into agreements with such third-parties on terms that are acceptable to us. If we are unable to successfully contract with third parties for these services when needed, or if existing arrangements for these services are terminated, whether or not through our actions, or if such third parties do not fully perform under these arrangements, we may have to delay, scale back or end one or more of our drug development programs or seek to develop or commercialize our drug candidates and technologies independently, which could result in delays. Further, such failure could result in the termination of license rights to one or more of our drug candidates and technologies. Moreover, if these development or marketing agreements take the form of a partnership or strategic alliance, such arrangements may provide our collaborators with significant discretion in determining the efforts and resources that they will apply to the development and commercialization of our products. Accordingly, to the extent that we rely on third parties to research, develop or commercialize our products, we may be unable to control whether such products will be scientifically or commercially successful.

***Even if we or our collaborative/strategic partners or potential collaborative/strategic partners receive approval to market our drug candidates, if our products fail to achieve market acceptance, we will never record meaningful revenues.***

Even if our products are approved for sale, they may not be commercially successful in the marketplace. Market acceptance of our product candidates will depend on a number of factors, including:

perceptions by members of the health care community, including physicians, of the safety and efficacy of our products;

- the rates of adoption of our products by medical practitioners and the target populations for our products;

the potential advantages that our products offer over existing treatment methods or other products that may be developed;

- the cost-effectiveness of our products relative to competing products including potential generic competition;
- the availability of government or third-party pay or reimbursement for our products;

the side effects of our products which may lead to unfavorable publicity concerning our products or similar products; and

- the effectiveness of our and/or partners' sales, marketing and distribution efforts.

Specifically, each of hCDR1, rHuEPO or SAM-101, if successfully developed and commercially launched for the treatment of SLE, Multiple Myeloma or Schizophrenia, respectively, will compete with both currently marketed and new products marketed by other companies. Health care providers may not accept or utilize any of our product candidates. Physicians and other prescribers may not be inclined to prescribe our products unless our products bring clear and demonstrable advantages over other products currently marketed for the same indications. Because we expect sales of our products to generate substantially all of our revenues in the long-term, the failure of our products to find market acceptance would harm our business and could require us to seek additional financing or other sources of revenue.

***If the third parties upon whom we rely to manufacture our products do not successfully manufacture our products, our business will be harmed.***

We do not currently have the ability to manufacture the compounds that we need to conduct our clinical trials and, therefore, rely upon, and intend to continue to rely upon, certain manufacturers to produce and supply our drug candidates for use in clinical trials and for future sales. In order to commercialize our products, such products will need to be manufactured in commercial quantities while adhering to all regulatory and other local requirements, all at an acceptable cost. We may not be able to enter into future third-party contract manufacturing agreements on acceptable terms, if at all.

If our contract manufacturers or other third parties fail to deliver our product candidates for clinical use on a timely basis, with sufficient quality, and at commercially reasonable prices, and we fail to find replacement manufacturers or sources, we may be required to delay or suspend clinical trials or otherwise discontinue development and production of our drug candidates.

Our contract manufacturers will be required to produce our clinical drug candidates under strict compliance with current Good Manufacturing Practices, or cGMP, in order to meet acceptable regulatory standards for our clinical trials. If such standards change, the ability of contract manufacturers to produce our drug candidates on the schedule we require for our clinical trials may be affected. In addition, contract manufacturers may not perform their obligations under their agreements with us or may discontinue their business before the time required by us to successfully produce and market our drug candidates. Any difficulties or delays in our contractors' manufacturing and supply of drug candidates could increase our costs, cause us to lose revenue or make us postpone or cancel clinical trials.

In addition, our contract manufacturers will be subject to ongoing periodic, unannounced inspections by the FDA and corresponding foreign or local governmental agencies to ensure strict compliance with, among other things, cGMP, in addition to other governmental regulations and corresponding foreign standards. We will not have control over, other than by contract, third-party manufacturers' compliance with these regulations and standards. No assurance can be given that our third-party manufacturers will comply with these regulations or other regulatory requirements now or in the future.

In the event that we are unable to obtain or retain third-party manufacturers, we will not be able to commercialize our products as planned. If third-party manufacturers fail to deliver the required quantities of our products on a timely basis and at commercially reasonable prices, our ability to develop and deliver products on a timely and competitive basis may be adversely impacted and our business, financial condition or results of operations will be materially harmed.

#### **Risks Related to Our Financial Condition**

***We fund our operations from our own capital and from external sources by way of issuing equity securities. If we need to raise additional capital and are unable to do so on terms favorable to us, or at all, we may not be able to continue our operations.***

The Company depends on external financing resources to continue its activities. The actual amount of cash that the Company will need to fund its operations is subject to many factors, including, but not limited to, the timing, design and conduct of the clinical trials of our existing drug candidates, any future projects which may be in-licensed or any other business development activities. For example, changing circumstances and/or in-licenses of new technologies may cause us to consume capital significantly faster than we currently anticipate, and we may need to spend more money than currently expected because of circumstances beyond our control.

The Company will incur additional losses in 2015 from research and development activities and from current operations which will be reflected in negative cash flows from operating activities. Accordingly, in order to complete the clinical trials to bring a product to market, the Company will be required to raise additional cash through the issuance of equity securities. However, if the Company is not able to raise additional capital at acceptable terms, the Company may be required to sell tradable securities held by it or reduce operations or sell or out-license to third parties some or all of its technologies. If the Company is unable to raise capital, the Company will be required to delay some of its planned research and development activities as well as curtail, cease or discontinue operations.

The financial condition of our drug development business depends on a number of factors, some of which are beyond our control. These factors include, among other things:

- the progress of our planned research activities;
- the accuracy of our financial forecasts;
- the number and scope of our planned development programs;
- our ability to establish and maintain current and new licensing or acquisition arrangements;

- our ability to achieve our milestones under our licensing arrangements;
- the costs involved in enforcing patent claims and other intellectual property rights;
- the costs and timing of the clinical trials according to regulatory requirements;
- rHuEPO patent expiration in 2019 and failure to obtain orphan drug designation in Europe;
- hCDR1 patent expiration in 2024 and failure to obtain patent term extension or obtain data exclusivity in the US and Europe;
- SAM-101 patent expiration in 2027; and
- The costs and timing of regulatory approvals.

The global capital markets have been experiencing extreme volatility and disruption for the last several years. Given recent market conditions, additional financing may not be available to us when we need it. In order to complete the clinical trials to bring a product to market we will need to raise additional capital. However we may be unable to do so on terms favorable to us, or at all, and we may be required to cease or reduce our operating activities or sell or license to third parties some or all of our technologies. If we raise additional funds by selling ordinary shares, ADSs, or other securities, the ownership interests of our shareholders will be diluted. If we need to raise additional funds through the sale or license of our drug candidates or technology, we may be unable to do so on terms favorable to us or at all.

### **Risks Related to Our Intellectual Property**

***If we are unable to adequately protect our intellectual property, third parties may be able to use our technology, which could adversely affect our ability to compete in the market.***

Our commercial success will depend in part on our ability and the ability of our licensors to obtain and maintain patent protection on our drug products and technologies and successfully defend these patents and technologies against third-party challenges. As part of our business strategy, our policy is to actively file patent applications in the US and internationally to cover methods of use, new chemical compounds, pharmaceutical compositions and dosing of the compounds and composition and improvements in each of these. Because of the extensive time required for development, testing and regulatory review of a potential product, it is possible that before we commercialize any of our products, any related patent may expire or remain in force for only a short period following commercialization,



thus reducing any advantage of the patent.

The patent positions of pharmaceutical and biotechnology companies can be highly uncertain and involve complex legal and factual questions. No consistent policy regarding the breadth of claims allowed in biotechnology patents has emerged to date. Accordingly, the patents we use may not be sufficiently broad to prevent others from practicing our technologies or from developing competing products. Furthermore, others may independently develop similar or alternative technologies or design around our patented technologies. The patents we use may be challenged or invalidated or may fail to provide us with any competitive advantage.

Generally, patent applications in the US are maintained in secrecy for a period of at least 18 months. Since publication of discoveries in the scientific or patent literature often lag behind actual discoveries, we are not certain that we were the first to make the inventions covered by each of our pending patent applications or that we were the first to file those patent applications. We cannot predict the breadth of claims allowed in biotechnology and pharmaceutical patents, or their enforceability. Third parties or competitors may challenge or circumvent our patents or patent applications, if issued. If our competitors prepare and file patent applications in the US that claim compounds or technology also claimed by us, we may be required to challenge competing patent rights, which could result in substantial cost, even if the eventual outcome is favorable to us. While we have the right to defend patent rights related to the licensed drug candidates and technologies, we are not obligated to do so. In the event that we decide to defend our licensed patent rights, we will be obligated to cover all of the expenses associated with that effort.

We also rely on trade secrets to protect technology where we believe patent protection is not appropriate or obtainable. Trade secrets are difficult to protect. While we require our employees, collaborators and consultants to enter into confidentiality agreements, this may not be sufficient to protect our trade secrets or other proprietary information adequately. In addition, we share ownership and publication rights to data relating to some of our drug candidates and technologies with our research collaborators and scientific advisors. If we cannot maintain the confidentiality of this information, our ability to protect our proprietary information will be at risk.

***Litigation or third-party claims of intellectual property infringement could require us to spend substantial time, money and other resources defending such claims and adversely affect our ability to develop and commercialize our products.***

Third parties may assert that we are using their proprietary technology without authorization. In addition, third parties may have or obtain patents in the future and claim that our products infringe their patents. If we are required to defend against patent suits brought by third parties, or if we sue third parties to protect our patent rights, we may be required to pay substantial litigation costs, and our management's attention may be diverted from operating our business. In addition, any legal action against our licensors or us that seeks damages or an injunction of our commercial activities relating to the affected products could subject us to monetary liability and require our licensors or us to obtain a license to continue to use the affected technologies. We cannot predict whether our licensors or we would prevail in any of these types of actions or that any required license would be made available on commercially acceptable terms, if at all. In addition, any legal action against us that seeks damages or an injunction relating to the affected activities could subject us to monetary liability and/or require us to discontinue the affected technologies or obtain a license to continue use thereof.

In addition, there can be no assurance that our patents or patent applications or those licensed to us will not become involved in opposition or revocation proceedings instituted by third parties. If such proceedings were initiated against one or more of our patents, or those licensed to us, the defense of such rights could involve substantial costs and the outcome could not be predicted.

Competitors or potential competitors may have filed applications for, may have been granted patents for, or may obtain additional patents and proprietary rights that may relate to compounds or technologies competitive with ours. If patents are granted to other parties that contain claims having a scope that is interpreted to cover any of our products (including the manufacture thereof), there can be no assurance that we will be able to obtain licenses to such patents at reasonable cost, if at all, or be able to develop or obtain alternative technology.

**Risks Related to Our ADSs**

***Our ADSs are traded in small volumes, limiting your ability to sell your ADSs that represent ordinary shares at a desirable price, if at all.***

The trading volume of our ADSs has historically been low. Even if the trading volume of our ADSs increases, we can give no assurance that it will be maintained or will result in a desirable stock price. As a result of this low trading volume, it may be difficult to identify buyers to whom you can sell your ADSs in desirable volume and you may be unable to sell your ADSs at an established market price, at a price that is favorable to you, or at all. A low volume market also limits your ability to sell large blocks of our ADSs at a desirable or stable price at any one time. You should be prepared to own our ADSs indefinitely.

*Our stock price can be volatile, which increases the risk of litigation and may result in a significant decline in the value of your investment.*

The trading price of the ADSs representing our ordinary shares is likely to be highly volatile and subject to wide fluctuations in price in response to various factors, many of which are beyond our control. These factors include:

- developments concerning our drug candidates or medical devices;
- announcements of technological innovations by us or our competitors;
- introductions or announcements of new products by us or our competitors;
- developments in the markets of the field of activities and changes in customer attributes;

announcements by us of significant acquisitions, in/out license transactions, strategic partnerships, joint ventures or capital commitments;

- changes in financial estimates by securities analysts;

actual or anticipated variations in interim operating results and near-term working capital as well as failure to raise required funds for the continued development and operations of the company;

- expiration or termination of licenses, patents, research contracts or other collaboration agreements;
- conditions or trends in the regulatory climate and the biotechnology and pharmaceutical industries;
- failure to obtain orphan drug designation status for the relevant drug candidates in the relevant regions;
- increase in costs and lengthy timing of the clinical trials according to regulatory requirements;
- failure to increase awareness of our products;

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- changes in reimbursement policy by governments or insurers in markets we operate or may operate in the future;
- any changes in the regulatory environment relating to the Company's products;
- failure to obtain renewal of the required licenses for marketing and sales of the Company's products in the main markets in which the Company's products are sold;
- changes in the market valuations of similar companies; and
- additions or departures of key personnel.

In addition, equity markets in general, and the market for biotechnology and life sciences companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies traded in those markets. These broad market and industry factors may materially affect the market price of our ADSs, regardless of our development and operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class-action litigation has often been instituted against that company. Such litigation, if instituted against us, could cause us to incur substantial costs to defend such claims and divert management's attention and resources even if we prevail in the litigation, all of which could seriously harm our business.

***Future issuances or sales of our ADSs could depress the market for our ADSs.***

Future issuances of a substantial number of our ADSs, or the perception by the market that those issuances could occur, could cause the market price of our ordinary shares or ADSs to decline or could make it more difficult for us to raise funds through the sale of equity in the future. Also, if we make one or more significant acquisitions in which the consideration includes ordinary shares or other securities, your portion of shareholders' equity in us may be significantly diluted.

***Concentration of ownership of our ordinary shares among our principal stockholders may prevent new investors from influencing significant corporate decisions.***

There are three shareholders (Mr. Alexander Rabinovitch, Sabby Management LLC and Mr. David Bassa), who each hold more than 5% of our outstanding ordinary shares (approximately 35.56% cumulative, as of the date hereof). As a result, these persons, either acting alone or together, may have the ability to significantly influence the outcome of all matters submitted to our shareholders for approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets. In addition, such persons, acting alone or together, may have the ability to effectively control our management and affairs. Accordingly, this concentration of ownership may depress the market price of our ordinary shares or ADSs.

Notwithstanding the aforesaid, in connection with Section 239 of the Israeli Companies Law that focuses on the number of votes required to appoint external directors, and in connection with Section 121(c) of the Israeli Companies Law that focuses on the number of votes required to authorize the Chairman of the Board in a company to act also as the Chief Executive Officer of such company, the Company will deem these two shareholders as controlling shareholders in the Company, for as long as such individuals are interested parties in the Company. In addition, any contractual arrangement as detailed in Section 270 (4) of the Israeli Companies Law with any of these three shareholders and/or their relatives will be presented for approval in accordance with the provisions of Section 275 of the Israeli Companies Law. In all of these situations, the Company will consider any of these three parties, who are not part of the transaction presented for approval, as individual interested parties in such transaction so that their vote will not be included in the quorum comprising a majority (50%) of the votes who are not interested parties in such

transaction.

*Our ordinary shares and ADSs trade on two different markets, and this may result in price variations and regulatory compliance issues.*

ADSs representing our ordinary shares are listed for trading on the Nasdaq Capital Market (“**Nasdaq**”) and our ordinary shares are traded on the TASE. Trading in our securities on these markets is made in different currencies and at different times, including as a result of different time zones, different trading days and different public holidays in the US and Israel. Consequently, the effective trading prices of our securities on these two markets may differ. Any decrease in the trading price of our securities on one of these markets could cause a decrease in the trading price of our securities on the other market.

***Holders of our ordinary shares or ADSs who are US citizens or residents may be required to pay additional income taxes.***

There is a risk that we will be classified as a passive foreign investment company, or PFIC, for certain tax years. If we are classified as a PFIC, a US holder of our ordinary shares or ADSs representing our ordinary shares will be subject to special federal income tax rules that determine the amount of federal income tax imposed on income derived with respect to the PFIC shares. We will be a PFIC if either 75% or more of our gross income in a tax year is passive income or the average percentage of our assets (by value) that produce or are held for the production of passive income in a tax year is at least 50%. The risk that we will be classified as a PFIC arises because cash balances, even if held as working capital, are considered to be assets that produce passive income. Therefore, any determination of PFIC status will depend upon the sources of our income and the relative values of passive and non-passive assets, including goodwill. A determination as to a corporation's status as a PFIC must be made annually. We believe that we were likely not a PFIC for the taxable years ended December 31, 2010, 2011, 2012 and 2013. Although such a determination is fundamentally factual in nature and generally cannot be made until the close of the applicable taxable year, based on our current operations, we believe that we were likely not a PFIC for the taxable year ended December 31, 2014, but we may be a PFIC in subsequent years. Although we may not be a PFIC in any one year, the PFIC taint remains with respect to those years in which we were or are a PFIC and the special PFIC taxation regime will continue to apply.

In view of the complexity of the issues regarding our treatment as a PFIC, US shareholders are urged to consult their own tax advisors for guidance as to our status as a PFIC.

***Provisions of Israeli corporate law may delay, prevent or affect a potential acquisition of all or a significant portion of our shares or assets and thereby depress the price of our ADSs and ordinary shares.***

We are incorporated in the State of Israel. Israeli corporate law regulates acquisitions of shares through tender offers. It requires special approvals for transactions involving significant shareholders and regulates other matters that may be relevant to these types of transactions. These provisions of Israeli law may delay or prevent an acquisition, or make it less desirable to a potential acquirer and therefore depress the price of our shares. Further, Israeli tax considerations may make potential transactions undesirable to us or to some of our shareholders.

Israeli corporate 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 such acquisition, the purchaser would become a 25% or greater shareholder of the company. This rule does not apply if there is already another 25% or greater shareholder of the company. Similarly, Israeli corporate 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's shareholdings would entitle the purchaser to over 45% of the shares in the company, unless there is a shareholder with 45% or more of the shares in the company. These requirements do not apply if, in general, the acquisition (1) was made in a private placement that received the approval of the company's



shareholders, (2) was from a 25% or greater shareholder of the company which resulted in the purchaser becoming a 25% or greater shareholder of the company, or (3) was from a 45% or greater shareholder of the company which resulted in the acquirer becoming a 45% or greater shareholder of the company. These rules do not apply if the acquisition is made by way of a merger.

Finally, in general, Israeli tax law treats specified acquisitions less favorably than does US tax law.

***Our ADS holders are not shareholders and do not have shareholder rights.***

The Bank of New York Mellon, as depositary, executes and delivers our ADSs on our behalf. Each ADS is a certificate evidencing a specific number of ADSs. Our ADS holders will not be treated as shareholders and do not have the rights of shareholders. The depositary will be the holder of the shares underlying our ADSs. Holders of our ADSs will have ADS holder rights. A deposit agreement among us, the depositary and our ADS holders, and the beneficial owners of ADSs, sets out ADS holder rights as well as the rights and obligations of the depositary. New York law governs the deposit agreement and the ADSs. Our shareholders have shareholder rights prescribed by Israeli law. Israeli law and our Articles of Association, or Articles, govern such shareholder rights. Our ADS holders do not have the same voting rights as our shareholders. Shareholders are entitled to our notices of general meetings and to attend and vote at our general meetings of shareholders. At a general meeting, every shareholder present (in person or by proxy, attorney or representative) and entitled to vote has one vote on a show of hands. Every shareholder present (in person or by proxy, attorney or representative) and entitled to vote has one vote per fully paid ordinary share on a poll. This is subject to any other rights or restrictions which may be attached to any shares. Our ADS holders may instruct the depositary to vote the ordinary shares underlying their ADSs, but only if we ask the depositary to ask for their instructions. If we do not ask the depositary to ask for their instructions, our ADS holders are not entitled to receive our notices of general meeting or instruct the depositary how to vote. Our ADS holders will not be entitled to attend and vote at a general meeting unless they withdraw the ordinary shares from the depositary. However, our ADS holders may not know about the meeting far enough in advance to withdraw the ordinary shares. If we ask for our ADS holders' instructions, the depositary will notify our ADS holders of the upcoming vote and arrange to deliver our voting materials and form of notice to them. The depositary will try, as far as is practical, subject to the provisions of the deposit agreement, to vote the shares as our ADS holders instruct. The depositary will not vote or attempt to exercise the right to vote other than in accordance with the instructions of the ADS holders. We cannot assure our ADS holders that they will receive the voting materials in time to ensure that they can instruct the depositary to vote their shares. In addition, there may be other circumstances in which our ADS holders may not be able to exercise voting rights.

Our ADS holders do not have the same rights to receive dividends or other distributions as our shareholders. Subject to any special rights or restrictions attached to a share, the directors may determine that a dividend will be payable on a share and fix the amount, the time for payment and the method for payment (although we have never declared or paid any cash dividends on our ordinary stock and we do not anticipate paying any cash dividends in the foreseeable future). Dividends and other distributions payable to our shareholders with respect to our ordinary shares generally will be payable directly to them. Any dividends or distributions payable with respect to ordinary shares will be paid to the depositary, which has agreed to pay to our ADS holders the cash dividends or other distributions it or the custodian receives on shares or other deposited securities, after deducting its fees and expenses. Our ADS holders will receive these distributions in proportion to the number of shares their ADSs represent. In addition, there may be certain circumstances in which the depositary may not pay to our ADS holders amounts distributed by us as a dividend or distribution.

***There are circumstances where it may be unlawful or impractical to make distributions to the holders of our ADSs.***

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The deposit agreement with the depository allows the depository to distribute foreign currency only to those ADS holders to whom it is possible to do so. If a distribution is payable by us in New Israeli Shekels, the depository will hold the foreign currency it cannot convert for the account of the ADS holders who have not been paid. It will not invest the foreign currency and it will not be liable for any interest. If the exchange rates fluctuate during a time when the depository cannot convert the foreign currency, our ADS holders may lose some of the value of the distribution.

The depository is not responsible if it decides that it is unlawful or impractical to make a distribution available to any ADS holders. This means that our ADS holders may not receive the distributions we make on our shares or any value for them if it is illegal or impractical for the depository to make such distributions available to them.

**Risks Relating to Operations in Israel**

***Conditions in the Middle East and in Israel may harm our operations.***

Our headquarters and some of our planned clinical sites and suppliers are located in Israel. Political, economic and military conditions in Israel directly affect our operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, as well as incidents of civil unrest, military conflicts and terrorist actions. There has been a significant increase in violence since September 2000, which has continued with varying levels of severity through to the present. This state of hostility has caused security and economic problems for Israel. To date, Israel is facing political tension in its relationships with Iran and other Arab neighbor countries. Specifically, the hostilities along Israel's border with the Gaza Strip have increased, escalating to wide scale military operations in December 2008, November 2012 and July 2014 amid continuous rocket attacks into the south and center of Israel. In addition, in recent years there have been violent uprisings against the regimes in some Arab countries in the Middle East and North Africa. Consequently, there is a concern for the stability in the region which may affect the political and security situation in Israel. We cannot ensure that the political and security situation will not impact our business. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could adversely affect our operations and could make it more difficult for us to raise capital.

Our commercial insurance does not cover losses that may occur as a result of events associated with the security situation in the Middle East. Although the Israeli government currently covers the reinstatement value of direct damages that are caused by terrorist attacks or acts of war, we cannot assure you that this government coverage will be maintained. Any losses or damages incurred by us could have a material adverse effect on our business. Any armed conflicts or political instability in the region would likely negatively affect business conditions and could harm our results of operations.

Further, the State of Israel and Israeli companies have been subjected to an economic boycott. Several countries still restrict business with the State of Israel and with Israeli companies. These restrictive laws and policies may have an adverse impact on our operating results, financial condition or the expansion of our business.

***Our results of operations may be adversely affected by inflation and foreign currency fluctuations.***

We have generated most of our revenues and hold most of our cash, cash equivalents, bank deposits and marketable securities in US dollars. Until 2008, a substantial amount of our operating expenses were in US dollars (approximately 96% in 2008). In 2009 the Company's head office moved back to Israel, and thus the portion of our expenses in New Israeli Shekels ("NIS") and our cash held in NIS has increased, mainly due to payment to Israeli employees and

suppliers. As a result, we could be exposed to the risk that the US dollar will be devalued against the NIS or other currencies, and consequentially our financial results could be harmed. To protect against currency fluctuations we may decide to hold a significant portion of our cash, cash equivalents, bank deposits and marketable securities in NIS, as well as to enter into currency hedging transactions. These measures, however, may not adequately protect us from the adverse effects of inflation in Israel. In addition, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the New Israeli Shekel in relation to the US dollar or that the timing of any devaluation may lag behind inflation in Israel.

***Our results of operations may be adversely affected by changes in tax policy by the Israeli government.***

The income of the Company is subject to corporate tax at the regular rate; the guidance of the amendment to the Income Tax Ordinance, 2005 from August 2008 prescribes a gradual reduction in the corporate tax rates and the resulting corporate tax rates starting 2008 are as follows: 2008 - 27%, 2009 - 26% and 2010 and thereafter - 25%.

On July 14, 2009, the “Knesset” (Israeli Parliament) passed the Law for Economic Efficiency (Amended Legislation for Implementing the Economic Plan for 2009 and 2010), 2009, which prescribes, among other things, an additional gradual reduction in the corporate tax rates starting 2011 to the following tax rates: 2011 - 24%, 2012 - 23%, 2013 - 22%, 2014 - 21%, 2015 - 20%, 2016 and thereafter - 18%.

On December 6, 2011 the reduction in the corporate tax rates outlined above was revoked by the Knesset and it was also resolved that the corporate tax rate will be 25% for the tax year 2012 and thereafter.

On August 5, 2013, the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013-2014), 2013 (the “**Law**”) was published in the Government’s records. Among other things, the Law prescribes from the 2014 tax year and thereafter, an increase in the Israeli corporate tax rate to 26.5% (instead of 25%).

We cannot guarantee that there will be no additional changes in the corporate tax rate in the future that may adversely affect our results of operations and financial condition.

*It may be difficult to enforce a US judgment against us, our officers or our directors or to assert US securities law claims in Israel.*

Service of process upon us, since we are incorporated in Israel, and upon our directors and officers, who reside outside the US, may be difficult to obtain within the US. In addition, because substantially all of our assets and most of our directors and officers are located outside the US, any judgment obtained in the US against us or any of our directors and officers may not be collectible within the US. There is a doubt as to the enforceability of civil liabilities under the Securities Act or the Exchange Act pursuant to original actions instituted in Israel. Subject to particular time limitations and provided certain conditions are met, executory judgments of a US court for monetary damages in civil matters may be enforced by an Israeli court.

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **A. History and Development of XTL**

We are a biopharmaceutical company engaged in the acquisition and development of pharmaceutical products for the treatment of unmet medical needs, currently for the treatment of SLE, Multiple Myeloma and Schizophrenia.

##### Recent Developments

## License for hCDR1

On January 7, 2014, the Company entered into a licensing agreement with Yeda to research, develop and commercialize hCDR1, a Phase II-ready asset for the treatment of SLE (“**Lupus**”), among other indications. Lupus is a debilitating disease affecting approximately five million people worldwide, according to the Lupus Foundation of America. hCDR1 is a peptide, short chains of amino acid monomers, and acts as a disease-specific treatment to modify the SLE-related autoimmune process. It does so by specific upstream immunomodulation through the generation of regulatory T cells, reducing inflammation and resuming immune balance. More than 40 peer-reviewed papers have been published on hCDR1.

Prior to being licensed to the Company by Yeda, hCDR1 was licensed to Teva Pharmaceutical Industries Ltd. (“**Teva**”), which performed two placebo controlled Phase I trials and a placebo controlled Phase II trial (the “**PRELUDE trial**”). The studies consisted of over 400 patients, demonstrating that hCDR1 is well tolerated by patients and has a favorable safety profile. The PRELUDE trial did not achieve its primary efficacy endpoint based on the SLEDAI scale, resulting in Teva returning the asset to Yeda. However, the PRELUDE trial showed encouraging results in its secondary clinical endpoint, the BILAG index, and, in fact, the 0.5 mg weekly dose showed a substantial effect. Multiple post-hoc analyses also showed impressive results for this dose using the BILAG index. It is currently planned by the Company that such dose will be the focus of the clinical development plan moving forward. Following Teva’s return of the program to Yeda, the FDA directed that the primary endpoint in future trials for Lupus therapies, including those for hCDR1, should be based on either the BILAG index or the SLE Responder Index (SRI). Given the FDA’s recommendation and the positive findings from the PRELUDE trial (which showed a substantial effect in the BILAG index), the Company is planning to initiate a new Phase II clinical trial, which will include the 0.5 mg (and a 0.25 mg) weekly dose of hCDR1.

## Investment in InterCure

On November 3, 2014, InterCure announced that on November 2, 2014, its Audit Committee and Board of Directors approved the signing of an agreement with Green Forest Global Ltd. (the “**Agreement**” and “**Green Forest**”, respectively) a company wholly owned by Mr. Alexander Rabinovitch, an interested party in the Company.

Pursuant to the Agreement, following a reverse split in InterCure shares at a 10:1 ratio, Green Forest will be allotted 2,622,647 ordinary shares of InterCure (the “**First Round Allotted Shares**”) representing 34.23% of the issued and outstanding shares of InterCure at the time of the allotment for an investment of \$ 230 thousand. Further, upon InterCure’s shares return to the main list of the TASE, an additional 2,622,648 ordinary shares of InterCure will be allotted to Green Forest for an additional investment of \$ 230 thousand (the “**Second Round Allotted Shares**”).

In addition, the Agreement grants Green Forest the following three options:

a. Option to purchase up to an additional 3,416,818 ordinary shares of InterCure for \$ 300 thousand (representing an exercise price of \$ 0.0878 per share), exercisable within 12 months of the Transaction Completion Date, as defined in the Agreement.

b. Option to acquire the Company shares held by InterCure at a price of NIS 0.35 per share, exercisable within 6 months of the Transaction Completion Date.

c. Option to acquire InterCure’s assets, rights and obligations relating to the “Resperate” business at the cost of inventory held at the time of the exercise of the option, exercisable within 6 months of the Transaction Completion Date.

Under the Agreement, Green Forest provided InterCure with a qualifying, non-secured, non-guaranteed, non-interest bearing and non-indexed loan of \$ 40 thousand for a period of 60 days. At the time of the completion of the transaction, the loan will be repaid by the sale of shares of the Company held by InterCure to Green Forest for the value of the loan (\$ 40 thousand) at a price of NIS 0.30 per share.

InterCure is granted the right to a Put option to sell all or part of the Company’s shares held by InterCure at the Put option exercise date, for an exercise price of NIS 0.30 per share, exercisable within 6 months of the Transaction Completion Date.



In addition, at the time of and as a condition for the completion of the transaction, the outstanding loan of \$ 50 thousand owed by InterCure to the Company will be converted to 569,470 ordinary shares of InterCure.

On December 23, 2014, the extraordinary general meeting of shareholders of InterCure approved the Agreement.

The Agreement was approved by the TASE and is effective as of February 12, 2015. Consequently, on February 15, 2015, the outstanding loan of \$ 50 thousand owed by InterCure to the Company was converted into 569,470 ordinary shares of InterCure, as mentioned above. After the conversion the Company's holdings in InterCure's issued and outstanding share capital decreased to 36.53%.

On March 23, 2015, InterCure issued 37,804,012 ordinary shares as part of a rights offering, thus diluting the Company's holding in InterCure's issued and outstanding share capital to approximately 6.16%.

On April 2, 2015, InterCure issued the Second Round Allotted Shares, thus diluting the Company's holding in InterCure's issued and outstanding share capital to approximately 5.82%.

Company Information and History

Our legal and commercial name is XTL Biopharmaceuticals Ltd. We were established as a private company limited by shares under the laws of the State of Israel on March 9, 1993, under the name Xenograft Technologies Ltd. We re-registered as a public company on June 7, 1993, in Israel, and changed our name to XTL Biopharmaceuticals Ltd. on July 3, 1995. We commenced operations to use and commercialize technology developed at the Weizmann Institute, in Rehovot, Israel. Until 1999, our therapeutic focus was on the development of human monoclonal antibodies to treat viral, autoimmune and oncological diseases. Our first therapeutic programs focused on antibodies against the hepatitis B virus, interferon – and the Hepatitis C virus.

In March 2009 we signed an asset purchase agreement to acquire the rights to develop rHuEPO for the treatment of Multiple Myeloma in exchange for the issuance of ordinary shares of XTL representing approximately 69.44% of our then issued and outstanding ordinary share capital. Under the agreement we are obligated to pay 1% royalties on net sales of rHuEPO, as well as a fixed royalty payment in the total amount of \$350,000 upon the success of Phase 2. Such payment of \$350,000 mentioned above shall be made to Yeda upon the earlier of (i) six months from the successful completion of Phase 2 or (ii) the completion of a successful fundraising by XTL at any time after the completion of Phase 2 of at least \$2 million.

On March 24, 2011, we entered into a Memorandum of Understanding with MinoGuard, pursuant to which we shall acquire the exclusive rights to SAM-101 by obtaining an exclusive license to use MinoGuard's entire technology. SAM-101 is based on a combination of anti-psychotic drugs with minocycline, a recognized medicinal compound. On November 30, 2011, we received a worldwide exclusive license from MinoGuard under which we shall develop and commercialize MinoGuard's technology for the treatment of psychotic disorders focusing on schizophrenia. Under the agreement, we are to conduct clinical trials, develop, register, market, distribute and sell the drugs that will emerge from MinoGuard's technology, with no limitations for a specific disorder. In consideration, we shall pay MinoGuard accumulated clinical development and marketing approvals milestone-based payments of approximately \$2.5 million. In addition, we will pay MinoGuard royalty-based payments on products that are based on the technology, equal to 3.5% of its net sales and/or percentage from the Company third-party out-license receipts in the range of 7.5%-20% according to the clinical phase of the drug at the time of an out-license transaction. It should be noted that the Company has the sole discretion to pay any of the above amounts in cash or by way of issuing ordinary shares of the Company to MinoGuard. In addition to the above payments, and in accordance with the above agreement, as of June 30, 2013, and as XTL had not commenced a phase 2 clinical trial as of that date, XTL paid MinoGuard an annual license fee, by way of the issuance of 175,633 ordinary shares of the Company, representing a value of \$45,000, for the 12 month period between July 1, 2013 and June 30, 2014. On September 3, 2014, the Company issued an additional 889,822 ordinary shares, representing a value of \$135,000, for the 12 month period between July 1, 2014 and June 30, 2015. Such annual payments will increase by \$90,000 per annum, up to \$675,000 for the eighth year of license or until the above agreement is terminated.

On January 7, 2014, the Company entered into a licensing agreement with Yeda to research, develop and commercialize hCDR1, a Phase II-ready asset for the treatment of SLE, among other indications. Lupus is a

debilitating disease affecting approximately five million people worldwide, according to the Lupus Foundation of America. hCDR1 is a peptide, short chains of amino acid monomers, and acts as a disease-specific treatment to modify the SLE-related autoimmune process. It does so by specific upstream immunomodulation through the generation of regulatory T cells, reducing inflammation and resuming immune balance. More than 40 peer-reviewed papers have been published on hCDR1.

Our ADSs are listed for trading on the Nasdaq Capital Market under the symbol “XTLB.” Our ordinary shares are traded on the TASE under the symbol “XTL.” We operate under the laws of the State of Israel under the Israeli Companies Law, and in the US, the Securities Act and the Exchange Act.

Our principal offices are located at 5 HaCharoshet Street, Raanana 43656, Israel, and our telephone number is +972-9-955-7080. Our primary internet address is [www.xtlbio.com](http://www.xtlbio.com). None of the information on our website is incorporated by reference herein.

## B. Business Overview

### *Introduction*

We are a biopharmaceutical company engaged in the acquisition and development of pharmaceutical drugs for the treatment of unmet medical needs, currently for the treatment of SLE, Multiple Myeloma and Schizophrenia.

Our lead program is hCDR1, a Phase II-ready asset for the treatment of SLE. Only one new treatment, Benlysta, has been approved in the last 50 years for SLE. Lupus is a chronic autoimmune disease involving many systems in the human body, including joints, kidneys, the central nervous system, heart, the hematological system and others. The biologic basis of the disease is a defect in the immune (defense) system, leading to production of self (auto) antibodies, attacking the normal organs and causing irreversible damage. According to the Lupus Foundation of America, at least 1.5 million Americans have the disease (more than 5 million worldwide) with more than 16,000 new cases diagnosed each year. The majority of patients are women of childbearing years.

hCDR1, is a peptide that is administered subcutaneously and acts as a disease-specific treatment to modify the SLE-related autoimmune process by specific upstream immunomodulation through the generation of regulatory T cells, reducing inflammation and resuming immune balance. More than 40 peer-reviewed papers have been published on hCDR1. Two placebo controlled Phase I trials and a placebo controlled Phase II trial, the PRELUDE trial, were conducted by Teva, which had previously in-licensed hCDR1 from Yeda. The studies consisted of over 400 patients, demonstrating that hCDR1 is well tolerated by patients and has a favorable safety profile. The PRELUDE trial did not achieve its primary efficacy endpoint based on the SLEDAI scale, resulting in Teva returning the asset to Yeda. However, the PRELUDE trial showed encouraging results in its secondary clinical endpoint, the BILAG index, and, in fact, the 0.5 mg weekly dose showed a substantial effect. Multiple post-hoc analyses also showed impressive results for this dose using the BILAG index. Such dose will be the focus of the clinical development plan moving forward. Subsequent to Teva's return of the program to Yeda, the FDA directed that the primary endpoint in future trials for Lupus therapies, including those for hCDR1, should be based on either the BILAG index or the SLE Responder Index (SRI). Given the FDA's recommendation and the positive findings from the PRELUDE trial (which showed a substantial effect in the BILAG index), XTL intends to initiate a new Phase II clinical trial, which will include the 0.5 mg (and a 0.25 mg) weekly dose of hCDR1.

Our second compound is rHuEPO, which we intend to develop for the extension of survival of patients with advanced/end-stage Multiple Myeloma.

Erythropoietin (“EPO”) is a glycoprotein hormone produced mainly by the kidney. It is the major growth regulator of the erythroid lineage. EPO stimulates erythropoiesis, the production of red blood cells, by binding to its receptor

(“**EPO-R**”) on the surface of erythroid progenitor cells, promoting their proliferation and differentiation and maintaining their viability. Over the last decade, several reports have indicated that the action of EPO is not restricted to the erythroid compartment, but may have additional biological, and consequently potential therapeutic properties, broadly beyond erythropoiesis. Erythropoietin is available as a therapeutic agent produced by recombinant DNA technology in mammalian cell culture. rHuEPO is used in clinical practice for the treatment of various anemias including anemia of kidney disease and cancer-related anemia.

Currently incurable, Multiple Myeloma is a severe plasma cell malignancy characterized by the accumulation and proliferation of clonal plasma cells in the marrow, leading to the gradual replacement of normal hematopoiesis. The course of the disease is progressive, and various complications occur, until death. This devastating disease affects the bone marrow, bones, kidneys, heart and other vital organs. It is characterized by pain, recurrent infections, anemia and pathological fractures. In the course of the disease, many patients become gradually disabled and bed-ridden.

The overall survival duration today with chemotherapy and other novel treatments is less than five years. These treatments have severe side effects, including the suppression of the immune system, susceptibility to infections, nausea, vomiting and bleeding disorders.

A clinical observation confirmed the high success rate of rHuEPO in treating the anemia in patients with Multiple Myeloma. Six patients with very poor prognostic features of Multiple Myeloma, whose expected survival was less than six months continued treatment with rHuEPO beyond the initial designed 12 week period, and they lived for 45–133 months cumulatively with the Multiple Myeloma diagnosis and 38–94 months with rHuEPO (with a good quality of life).

Our third program, SAM-101, is based on the technology we in-licensed from MinoGuard - the development of combination drugs for psychotic diseases, with focus on Schizophrenia. MinoGuard completed a phase 2a study on SAM-101 in accordance with the Helsinki guidelines under the Shalvata Medical Center in Israel. SAM-101 is a unique proprietary combination of antipsychotic drugs and a known medicinal compound (minocycline). Schizophrenia is a chronic disorder that requires lifelong medication. While most of the available drugs are effective in remitting Schizophrenia's "positive symptoms" (hallucinations, delusions, agitation), even the best available drug is only partially effective in remitting several of the most disturbing features of the disease, referred to as "negative symptoms" (apathy, poverty of speech, emotional withdrawal, depression) and severe cognitive impairment. This deficiency results in schizophrenic patients' poor quality of life. In addition, noncompliance results in aggravation of symptoms, which frequently causes lengthy hospitalization periods.

Following in-vivo studies demonstrating the efficacy of minocycline treatment in a Schizophrenia murine model, MinoGuard demonstrated in a successful phase 2a clinical study that the combination of atypical antipsychotic drugs and minocycline improves treatment efficacy and reduces side effects associated with current therapy as compared to antipsychotic treatment alone. Two independent clinical research groups in Manchester, UK and Japan have replicated these results, further supporting MinoGuard's hypothesis.

The Company's strategy does not include the investment of significant resources in the development of SAM-101 in the foreseeable future and as noted below the Company intends to seek collaboration with large pharmaceutical companies to sublicense/develop and market the SAM-101 program.

### *Our Strategy*

Our objective is to be a leading biopharmaceutical company engaged in the acquisition and development of pharmaceutical products for the treatment of unmet clinical needs, currently for the treatment of SLE, Multiple Myeloma and Schizophrenia. We continuously identify and in-license therapeutic candidates in order to maximize our potential for commercial success.

Under our current strategy with respect to our pharmaceutical and biopharmaceutical products, we plan to:

- initiate an international, prospective phase 2 clinical study intended to assess the safety and efficacy of hCDR1 when given to patients with SLE;

- initiate a prospective phase 2 clinical study intended to assess the safety and efficacy of rHuEPO when given to patients with advanced Multiple Myeloma;

continually build our pipeline of therapeutic candidates; and

develop collaborations with large pharmaceutical companies to sublicense/develop, and market our hCDR1, rHuEPO and SAM-101 programs.

With regard to our medical device business, we plan to maximize the value of our asset and focus on our core business.

## *Products Under Development*

### hCDR1 for the treatment of Systemic Lupus Erythematosus

#### *Market Opportunity*

hCDR1 is a Phase II-ready asset for the treatment of SLE. Lupus is a debilitating disease affecting approximately five million people worldwide according to the Lupus Foundation of America. hCDR1, a peptide, is given by subcutaneous administration, and acts as a disease-specific treatment to modify the SLE-related autoimmune process. It does so by specific upstream immunomodulation through the generation of regulatory T cells, reducing inflammation and resuming immune balance. The approval of GlaxoSmithKline's Benlysta in 2011, the first product to gain marketing approval for patients with SLE in more than 50 years, paved the way for the introduction of new disease-modifying therapies and reignited the interest of pharmaceutical developers in this therapy area. GlobalData estimates the drug sales for SLE in 2012 were over \$473 million across the seven major markets covered in its forecast: US, France, Germany, Italy, Spain, UK and Japan. By the end of the forecast period of 2022, sales are estimated to grow to over \$1.1 billion with a CAGR of 9.36%. This growth will be driven by improved uptake of Benlysta, and the introduction of new biological therapies and the overall increase in prevalent cases of SLE, mainly due to the increasing population in these markets.

Regarding products in the pipeline, there are five advanced biological therapies. a number of pharmaceutical companies including Anthera Pharmaceuticals and Merck Serono, which are developing anti-BLyS therapies to directly compete with Benlysta (also an anti-BLyS therapy). All new anti-BLyS therapies are being developed for subcutaneous administration. Benlysta is currently given intravenously, even though GSK is currently developing a version for subcutaneous administration. UCB and ImmuPharma are developing biologic drugs with novel MOAs (UCB's drug is an antibody which is given intravenously). In addition, Bristol-Myers Squibb is developing its RA drug Orencia for the treatment of patients with Lupus Nephritis.

#### *Development Status*

Prior to being licensed to the Company by Yeda, hCDR1 was licensed to Teva which performed two placebo controlled Phase I trials and a placebo controlled Phase II trial (the "**PRELUDE trial**"). The Phase I and Phase II studies consisted of over 400 patients, demonstrating that hCDR1 is well tolerated by patients and has a favorable safety profile. The PRELUDE trial did not achieve its primary efficacy endpoint based on the SLEDAI scale, resulting in Teva returning the asset to Yeda. However, the PRELUDE trial showed encouraging results in its secondary clinical endpoint, the BILAG index, and, in fact, the 0.5 mg weekly dose showed a substantial effect. Multiple post-hoc analyses also showed impressive results for this dose using the BILAG index. The Company plans such dose



to be the focus of clinical development moving forward. Subsequent to Teva's return of the program to Yeda, the FDA directed that the primary endpoint in future trials for Lupus therapies, including those for hCDR1, should be based on either the BILAG index or the SRI. Given the FDA's recommendation and the positive findings from the PRELUDE trial (which showed a substantial effect in the BILAG index), the Company intends to initiate a new Phase II clinical trial, which will include the 0.5 mg (and a 0.25 mg) weekly dose of hCDR1.

### **rHuEPO for the treatment of Multiple Myeloma**

#### *Market Opportunity*

We intend to develop rHuEPO for the prolongation of Multiple Myeloma patients' survival. In the United States alone, there are approximately 74,800 people living with Multiple Myeloma. Multiple Myeloma is the second most prevalent blood cancer representing approximately 1% of all cancers in white US residents and 2% of all cancers in African Americans. The average age at diagnosis is 65-70 and it is more common in men than women and in African Americans than Caucasians.

Erythropoietin, a glycoprotein hormone produced mainly by the kidney, is the major growth regulator of the erythroid lineage. EPO stimulates erythropoiesis by binding to its receptor on the surface of erythroid progenitor cells, promoting their proliferation and differentiation and maintaining their viability. The cloning of the EPO gene led to the introduction of rHuEPO into clinical practice for the treatment of various anemias including anemia of kidney disease and cancer-related anemia.

Over the last decade, several reports have indicated that the action of EPO is not restricted to the erythroid compartment, but may have additional biological, and consequently potential therapeutic properties, broadly beyond erythropoiesis. A clinical observation confirmed the high success rate of rHuEPO in treating the anemia in patients with Multiple Myeloma. Six patients with very poor prognostic features of Multiple Myeloma, whose expected survival was less than six months continued treatment with rHuEPO beyond the initial designed 12 week period, and lived for 45–133 months cumulatively with the Multiple Myeloma diagnosis and 38–94 months with rHuEPO (with a good quality of life).

### *Development Status*

As of the date hereof, the Company is in stages of planning and preparing for the implementation of a phase 2 clinical trial of rHuEPO for treating Multiple Myeloma patients. As part of those preparations, the Company conducted a study which consists of collecting preliminary data on the existence of specific proteins in the blood of a group of Multiple Myeloma patients. The data which was collected in the framework of the preliminary study will be combined, as necessary, in planning and preparing for the implementation of the phase 2 clinical trial which the Company expects to obtain the approval to commence in the second half of 2015.

We plan on performing a prospective, multi-center, open-label, one arm phase 2 study intended to demonstrate its effects on survival, biological markers related to the disease, immune improvements and quality of life. We have begun regulatory work and have held preliminary discussions with potential drug suppliers, clinical sites and third party vendors for the planned study.

Given that we intend to develop a new indication for rHuEPO, which is already approved for other uses, and we intend to use a commercially available rHuEPO as part of the study, and the fact that the pre-clinical and phase 1 phases are intended to assess drug toxicity and safety, we may be exempted from carrying out these steps and the drug development process may begin with a Phase 2 clinical trial.

### *Intellectual Property and Patent*

#### **General**

Patents and other proprietary rights are very important to the development of our business. We will be able to protect our proprietary technologies from unauthorized use by third parties only to the extent that our proprietary rights are covered by valid and enforceable patents or are effectively maintained as trade secrets. It is our intention to seek and maintain patent and trade secret protection for our drug candidates and our proprietary technologies. As part of our business strategy, our policy is to file patent applications in the US and internationally to cover methods of use, new chemical compounds, pharmaceutical compositions and dosing of the compounds and compositions and improvements in each of these. We also rely on trade secret information, technical know-how, innovation and agreements with third parties to continuously expand and protect our competitive position. Because of the extensive time required for development, testing and regulatory review of a potential product, it is possible that before we commercialize any of our products, any related patent may expire or remain in existence for only a short period following commercialization, thus reducing any commercial advantage or financial value attributable to the patent.

Generally, patent applications in the US are maintained in secrecy for a period of at least 18 months. Since publication of discoveries in the scientific or patent literature often lag behind actual discoveries, we are not certain that we were the first to make the inventions covered by each of our pending patent applications or that we were the first to file those patent applications. The patent positions of biotechnology and pharmaceutical companies are highly uncertain and involve complex legal and factual questions. Therefore, we cannot predict the breadth of claims allowed in biotechnology and pharmaceutical patents, or their enforceability. To date, there has been no consistent policy regarding the breadth of claims allowed in biotechnology patents. Third parties or competitors may challenge or circumvent our patents or patent applications, if issued. Granted patents can be challenged and ruled invalid at any time, therefore the grant of a patent is not of itself sufficient to demonstrate our entitlement to a proprietary right. The disallowance of a claim or invalidation of a patent in any one territory can have adverse commercial consequences in other territories.

If our competitors prepare and file patent applications in the US that claim technology also claimed by us, we may choose to challenge competing patent rights, which could result in substantial cost, even if the eventual outcome is favorable to us. While we have the right to defend patent rights related to our licensed drug candidates and technologies, we are not obligated to do so. In the event that we decide to defend our licensed patent rights, we will be obligated to cover all of the expenses associated with that effort.

If a patent is issued to a third party containing one or more preclusive or conflicting claims, and those claims are ultimately determined to be valid and enforceable, we may be required to obtain a license under such patent or to develop or obtain alternative technology. In the event of a litigation involving a third party claim, an adverse outcome in the litigation could subject us to significant liabilities to such third party, require us to seek a license for the disputed rights from such third party, and/or require us to cease use of the technology. Further, our breach of an existing license or failure to obtain a license to technology required to commercialize our products may seriously harm our business. We also may need to commence litigation to enforce any patents issued to us or to determine the scope, validity and/or enforceability of third-party proprietary rights. Litigation would involve substantial costs.

### **hCDR1 for the treatment of SLE**

The basic patent family (WO 2002/067848) covers the active pharmaceutical agent, the Edratide peptide. The patent has been granted in a large number of jurisdictions: US, Europe (validated in 13 countries), Australia, Canada, Hong Kong, Hungary, India, Israel, Korea, Mexico, Norway, and Russia. The patent expires on February 26, 2022. The basic patent for Edratide, in the US, did receive a patent term adjustment of 213 days (to September 27, 2022). The patent family for the formulation (WO 2004/064788) covers a very specific pharmaceutical composition comprising Edratide. It has been granted in the US, China, India, Israel, Japan, and Mexico, and is under examination in Europe and Canada. The formulation patent expires on January 14, 2024.

### **rHuEPO for the treatment of Multiple Myeloma**

A main use patent, United States Patent 6,579,525 “Pharmaceutical Compositions Comprising Erythropoietin for Treatment of Cancer,” was filed by Mor and Yeda in Israel on April 8, 1998. The patent was granted in the United States, Europe (Austria, Belgium, France, Germany, Great Britain, Ireland, Italy, Netherlands, Spain, Sweden and Switzerland), Israel, Japan, Hong Kong and Canada. The issued patent will expire in 2019 (See “Government and Industry Regulation” regarding our granted orphan drug designation). Pursuant to our agreement with Bio-Gal, we have exclusive worldwide rights to the above patent for the use of rHuEPO in Multiple Myeloma.

The main claims of this US issued patent are directed to: A method for the treatment of a Multiple Myeloma patient, comprising the administration of Erythropoietin or Recombinant Human Erythropoietin, for the inhibition of tumor growth, triggering of tumor regression or inhibition of Multiple Myeloma cell metastasis in the said patient.

### **SAM-101 for the Treatment of Schizophrenia**

An international patent application entitled “Combined therapies of antipsychotic drugs and tetracyclines in the treatment of psychiatric disorders” was filed by Mor on October 18, 2007 (International application number PCT/IL2007/001251). The patent is currently pending in National Phase in the US, Canada, Europe, India, and Israel.

The main claims of this patent include a pharmaceutical composition comprising as active ingredients at least one tetracycline and at least one antipsychotic drug, the pharmaceutical composition with modified release formulation, and a method for treating a psychotic disorder comprising administering the pharmaceutical composition to a patient in need.

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The patent applications are pending as National Phase in Israel, US, Canada, Europe, and India. The table below details the current status of the patent applications:

<b>Countries in which application was filed</b>	<b>Filing Date</b>	<b>Application No.</b>	<b>Patent No.</b>	<b>Status</b>	<b>Expiration Date*</b>
Canada	18.10.2007	2666796	-	Filed	18.10.2027
Europe	18.10.2007	07827225.9	-	Examination	18.10.2027
India	18.10.2007	3100/DELNP/2009	-	Filed	18.10.2027
Israel	18.10.2007	198134	-	Examination	18.10.2027
PCT	29.03.2007	PCT/IL2007/000414	-	Expired	
PCT-1	18.10.2007	PCT/IL2007/001251	-	Expired	
US Prov.	19.10.2006	60/852646	-	Expired	
USA	18.10.2007	13/733130	-	Examination	18.10.2027

\* assuming that the patent will be registered on the basis of the PCT.

### **Other Intellectual Property Rights**

We depend upon trademarks, trade secrets, know-how and continuing technological advances to develop and maintain our competitive position. To maintain the confidentiality of trade secrets and proprietary information, we require our employees, scientific advisors, consultants and collaborators, upon commencement of a relationship with us, to execute confidentiality agreements and, in the case of parties other than our research and development collaborators, to agree to assign their inventions to us. These agreements are designed to protect our proprietary information and to grant us ownership of technologies that are developed in connection with their relationship with us. These agreements may not, however, provide protection for our trade secrets in the event of unauthorized disclosure of such information.

### ***Licensing Agreements and Collaborations***

#### **hCDR1**

On January 7, 2014, the Company entered into a licensing agreement with Yeda to research, develop, and commercialize hCDR1, a Phase II-ready asset for the treatment of SLE, among other indications. In consideration, the Company is responsible for a patent expense reimbursement in six installments totaling approximately \$400,000. The Company is required to make milestone payments of \$2.2 million: \$200,000 upon starting Phase III, \$1 million upon U.S. Food and Drug Administration approval and \$250,000 for regulatory approval in each of China and three of the European Union's Group of Six. In addition, the Company will pay 2-3% royalties of annual net sales and sublicense fees of 15-20% of whatever the Company receives from any sub-licensee.

Lupus is a debilitating disease affecting approximately five million people worldwide according to the Lupus Foundation of America. hCDR1, is a peptide and acts as a disease-specific treatment to modify the SLE-related autoimmune process. It does so by specific upstream immunomodulation through the generation of regulatory T cells, reducing inflammation and resuming immune balance. Prior to being licensed to the Company by Yeda, hCDR1 was licensed to Teva Pharmaceutical Industries ("Teva"), which performed two placebo controlled Phase I trials and a placebo controlled Phase II trial called the PRELUDE trial. The studies consisted of over 400 patients, demonstrating that hCDR1 is well tolerated by patients and has a favorable safety profile. The PRELUDE trial did not achieve its primary efficacy endpoint based on the SLEDAI scale, resulting in Teva returning the asset to Yeda. However, the PRELUDE trial showed encouraging results in its secondary clinical endpoint, the BILAG index, and, in fact, the 0.5 mg weekly dose showed a substantial effect. Multiple post-hoc analyses also showed impressive results for this dose using the BILAG index. The Company plans such dose to be the focus of clinical development moving forward. Subsequent to Teva's return of the program to Yeda, the FDA directed that the primary endpoint in future trials for Lupus therapies, including those for hCDR1, should be based on either the BILAG index or the SRI. Given the FDA's recommendation and the positive findings from the PRELUDE trial (which showed a substantial effect in the BILAG index), the Company intends to initiate a new Phase II clinical trial, which will include the 0.5 mg (and a 0.25 mg) weekly dose of hCDR1. We estimate that the trial will take approximately one year to enroll patients, another year for

the treatment phase, and additional time to analyze the results for a total of approximately two and a half years. We intend to request an interim analysis be conducted as well.

On May 14, 2014, the Company issued 222,605 Ordinary shares of the Company of NIS 0.1 par value each to Yeda, as the first of six installments for the aforementioned patent expenses reimbursement, representing a value of approximately \$ 38 thousand.

On January 21, 2015, the Company issued Yeda 802,912 Ordinary shares of the Company of NIS 0.1 par value each, as the second of six installments for the aforementioned patent expenses reimbursement, representing a value of approximately \$ 89 thousand.



### **Bio-Gal/XTEPO**

In March 2009 we signed an asset purchase agreement to acquire the rights to develop rHuEPO for the treatment of Multiple Myeloma. We are obligated to pay 1% royalties on net sales of the product, as well as a fixed royalty payment in the total amount of \$350,000 upon the successful completion of Phase 2. Such payment of \$350,000 is payable to Yeda upon the earlier of (i) six months from the successful completion of Phase 2 or (ii) the completion of a successful fundraising by XTL at any time after the completion of the Phase 2 of at least \$2 million.

### **MinoGuard License**

In November 2011, the Company acquired the assets of MinoGuard by an exclusive license to use MinoGuard's entire technology in return for royalties on sales and milestone payments throughout the clinical development process, without any other payments. MinoGuard was founded in 2007 in order to commercialize combination therapies for treating psychotic diseases, focusing on Schizophrenia. Under the terms of the license agreement we shall pay MinoGuard accumulated clinical development and marketing approvals milestone-based payments of approximately \$2.5 million. In addition, we will pay MinoGuard royalty-based payments on products that are based on the technology, equal to 3.5% of net sales and/or a percentage of our third-party out-license receipts in the range of 7.5%-20% according to the clinical phase of the drug at the time of an out-license transaction. It should be noted that the Company has the sole discretion to pay any of the above amounts in cash or by way of issuing of its shares to MinoGuard. In addition to the above payments, since as of June 30, 2013, XTL had not commenced a phase 2 clinical trial, we paid MinoGuard an annual license fee, by way of issuance of 175,633 ordinary shares of the Company, representing a value of \$45,000, for the 12 month period between July 1, 2013 and June 30, 2014. On September 3, 2014, the Company issued an additional 889,822 ordinary shares, representing a value of \$135,000, for the 12 month period between July 1, 2014 and June 30, 2015. Such annual payments will increase by \$90,000 per annum, up to \$675,000 for the eighth year of the license.

The term of the license commenced upon the signing of the license agreement and will be effective for an unlimited time. Upon the expiration of the last payment obligation of XTL the license will be considered perpetual and fully paid up.

### **URL addresses**

XTL maintains the [www.xtlbio.com](http://www.xtlbio.com) URL address.

*Competition*

Competition in the pharmaceutical and biotechnology industries is intense. Our competitors include pharmaceutical companies and biotechnology companies, as well as universities and public and private research institutions. In addition, companies that are active in different but related fields represent substantial competition for us. Many of our competitors have significantly greater capital resources, larger research and development staffs and facilities and greater experience in drug development, regulation, manufacturing and marketing than we do. These organizations also compete with us to recruit qualified personnel, attract partners for joint ventures or other collaborations, and license technologies that are competitive with ours. To compete successfully in this industry we must identify novel and unique drugs or methods of treatment and then complete the development of those drugs as treatments in advance of our competitors.

The drugs that we are attempting to develop will have to compete with existing therapies. In addition, a large number of companies are pursuing the development of pharmaceuticals that target the same diseases and conditions that we are targeting. Other companies have products or drug candidates in various stages of pre-clinical or clinical development to treat diseases for which we are also seeking to discover and develop drug candidates. Some of these potential competing drugs are further advanced in development than our drug candidates and may be commercialized earlier.

### **Competing Products for Treatment of SLE**

There is only one product that has been approved for SLE in the last 50 years, GlaxoSmithKline's Benlysta which was approved in 2011. Regarding products in the pipeline, there are five advanced biological therapies. a number of pharmaceutical companies including Anthera Pharmaceuticals and Merck Serono, which are developing anti-BLyS therapies to directly compete with Benlysta (also an anti-BLyS therapy). All new anti-BLyS therapies are being developed for subcutaneous administration. Benlysta is currently given intravenously, even though GSK is currently developing a version for subcutaneous administration. UCB and ImmuPharma are developing biologic drugs with novel MOAs (UCB's drug is an antibody which is given intravenously). In addition, Bristol-Myers Squibb is developing its RA drug Orencia for the treatment of patients with Lupus Nephritis.

### **Competing Products for Treatment of Multiple Myeloma**

Although there are commercially available drugs for the treatment of Multiple Myeloma, we plan to conduct our clinical trial so that rHuEPO will be tested and given only to patients who have been treated with and either failed treatment or need to stop taking, all standard therapy. Thus, the drugs below are not in direct competition to our drug. However, rHuEPO may improve the current treatments and therefore may be supplementary to them, as follows:

**Thalidomide** is effective in approximately one-third of patients (for a certain period of time) with advanced disease and is synergistic with other agents active in Multiple Myeloma. Its exact mechanism of action is unclear, but inhibition of angiogenesis, modulation of cytokines, and immunological effects are probably involved. Thalidomide, as a single agent or in combination with steroids, is now the standard first line treatment for relapsed or refractory myeloma (if not used before) and is also being used as frontline and maintenance treatment. Newer derivatives of thalidomide, such as revlimid or lenalidomide (formerly CC5013), have potentially greater biological activity and fewer adverse effects, including teratogenicity. Preliminary studies show a response in 30-50% of patients with refractory disease. Thalidomide has severe side effects such as flu-like symptoms, constipation, neuropathy and thrombophilia, and has not yet demonstrated survival advantage.

**Lenalidomide (Revlimid)** is used with dexamethasone to treat patients with Multiple Myeloma who have already had another treatment. It is a small molecular analog of thalidomide that was originally found based on its ability to effectively inhibit tumor necrosis factor production. Lenalidomide is 50,000 times more potent than thalidomide in inhibiting tumor necrosis factor-alpha, and has less severe adverse drug reactions. Nonetheless, lenalidomide, like its parent compound thalidomide, causes venous thromboembolism (VTE), a potentially serious complication with their use.

**Bortezomib (Velcade)** inhibits the proteasome, an intracellular organelle responsible for protein disposal. The response rate to bortezomib in extensively treated myeloma is around 50%. The drug has recently been approved by the FDA based on phase 2 clinical results. The drug has several serious side effects, including neuropathy.

**Carfilzomib (Kyprolis):** This is a new generation or a novel derivative of proteasome-inhibitor, i.e. the new modern “Bortezomib”. It was already approved by the FDA as a second or third line therapy for relapsed or resistant myeloma. This was based on phase 2 clinical trials, and trials, including in Israel, are going on. According to the information gained so far, it appears that some of the previously resistant Multiple Myeloma patients to Velcade (Bortezomib) might respond to Carfilzomib. It is still too early to determine whether the novel drug indeed prolongs life (overall survival) or only prolongs the progression-free survival.

**Pomalidomide (Pomalyst)** has been approved by the FDA just recently, also for the treatment of relapsed/resistant Multiple Myeloma, as a second-third line treatment. This agent belongs to the INiDs family of drugs, and in essence, is considered as the novel lenalidomide.

It is important to emphasize that studies with Carfilzomib and Pomalidomide are ongoing and their real role in the treatment of Multiple Myeloma has not been completely clarified.

**Traditional chemotherapy** treatment includes melphalan and prednisone, now used sparingly because of its propensity to compromise collection of haematopoietic stem cells, other combinations, and regimens containing high dose corticosteroids. The latter-including dexamethasone; vincristine, doxorubicin, and dexamethasone; and cyclophosphamide, vincristine, doxorubicin, and methylprednisolone -are preferred for transplant candidates.

**High dose chemotherapy**, particularly melphalan, with autologous haematopoietic stem cell transplantation improves response rates and their duration and survival compared with conventional chemotherapy. It is now commonly used as consolidation treatment. Unfortunately, even after haematopoietic stem cell transplantation, relapse is only a matter of time, although a minority of patients seems to survive over a decade in remission (“operational cure”). Maintenance treatment after transplantation with corticosteroids or interferon is often prescribed in an attempt to delay relapse. Although this probably does prolong the duration of remission, it is unclear if it confers a survival benefit.

**Allogeneic haematopoietic stem cell transplantation** might potentially cure a proportion of patients through immunologically mediated graft versus myeloma effect. However, this procedure remains highly experimental at the present time. High mortality related to treatment has been a problem historically, but the use of safer preparative regimens of reduced intensity could improve long term results.

### *Supply and Manufacturing*

We currently have no manufacturing capabilities and do not intend to establish any such capabilities.

### **hCDR1 for the treatment of SLE**

We believe that we will be able to outsource production to a contract manufacturer in order to obtain sufficient inventory to satisfy the clinical supply needs for our future development for the treatment of SLE.

### **rHuEPO for the treatment of Multiple Myeloma**

We believe that we will either be able to purchase rHuEPO from existing pharmaceutical companies or to enter into collaborative agreements with contract manufacturers or other third-parties to obtain sufficient inventory to satisfy the clinical supply needs for our planned development program for the treatment of Multiple Myeloma.

### **SAM-101 for the Treatment of Schizophrenia**

We believe that we will either be able to purchase the selected antipsychotic and minocycline from existing pharmaceutical companies or to enter into collaborative agreements with contract manufacturers or other third-parties to obtain sufficient inventory to satisfy the clinical supply needs for our future development for the treatment of Schizophrenia.

## General

At the time of commercial sale, to the extent that it is possible and commercially practicable, we plan to engage a back-up supplier for each of our product candidates. Until such time, we expect that we will rely on a single contract manufacturer to produce each of our product candidates under cGMP regulations. Our third-party manufacturers have a limited number of facilities in which our product candidates can be produced and will have limited experience in manufacturing our product candidates in quantities sufficient for conducting clinical trials or for commercialization. Our third-party manufacturers will have other clients and may have other priorities that could affect our contractor's ability to perform the work satisfactorily and/or on a timely basis. Both of these occurrences would be beyond our control. We anticipate that we will similarly rely on contract manufacturers for our future proprietary product candidates.

We expect to similarly rely on contract manufacturing relationships for any products that we may in-license or acquire in the future. However, there can be no assurance that we will be able to successfully contract with such manufacturers on terms acceptable to us, or at all.

Contract manufacturers are subject to ongoing periodic inspections by the FDA, the US Drug Enforcement Agency and corresponding state and local agencies to ensure strict compliance with cGMP and other state and federal regulations. We do not have control over third-party manufacturers' compliance with these regulations and standards, other than through contractual obligations.

If we need to change manufacturers, the FDA and corresponding foreign regulatory agencies must approve these new manufacturers in advance, which will involve testing and additional inspections to ensure compliance with FDA regulations and standards and may require significant lead times and delay. Furthermore, switching manufacturers may be difficult because the number of potential manufacturers is limited. It may be difficult or impossible for us to find a replacement manufacturer quickly or on terms acceptable to us, or at all.

### *Government and Industry Regulation*

Numerous governmental authorities, principally the FDA and corresponding state and foreign regulatory agencies, impose substantial regulations upon the clinical development, manufacture and marketing of our drug candidates and technologies, as well as our ongoing research and development activities. None of our drug candidates have been approved for sale in any market in which we have marketing rights. Before marketing in the US, any drug that we develop must undergo rigorous pre-clinical testing and clinical trials and an extensive regulatory approval process implemented by the FDA, under the Federal Food, Drug and Cosmetic Act of 1938, as amended. The FDA regulates, among other things, the pre-clinical and clinical testing, safety, efficacy, approval, manufacturing, record keeping, adverse event reporting, packaging, labeling, storage, advertising, promotion, export, sale and distribution of biopharmaceutical products.

The regulatory review and approval process is lengthy, expensive and uncertain. We are required to submit extensive pre-clinical and clinical data and supporting information to the FDA for each indication or use to establish a drug candidate's safety and efficacy before we can secure FDA approval. The approval process takes many years, requires the expenditure of substantial resources and may involve ongoing requirements for post-marketing studies or surveillance. According to the FDA, before commencing clinical trials in humans, we must submit an IND to the FDA containing, among other things, pre-clinical data, chemistry, manufacturing and control information, and an investigative plan. Our submission of an IND may not result in FDA authorization to commence a clinical trial.

The Company was granted an Orphan-drug designation from the FDA in May 2011, for rHuEPO. In the US, Orphan-drug designation is granted by the FDA Office of Orphan Drug Products to novel drugs or biologics that treat a rare disease or condition affecting fewer than 200,000 patients in the US. The designation provides the drug developer with a seven-year period of US marketing exclusivity if the drug is the first of its type approved for the specified indication or if it demonstrates superior safety, efficacy, or a major contribution to patient care versus another drug of its type previously granted the designation for the same indication, as well as with tax credits for clinical research costs, the ability to apply for annual grant funding, clinical research trial design assistance and waiver of Prescription Drug User Fee Act filing fees.

The Company may apply to the European Medicines Agency in order to obtain Orphan-drug designation for its Recombinant Erythropoietin in Europe. Orphan designation is granted by the European Medicines Agency, following a positive opinion from the Committee for Orphan Medicinal Products, to a medicinal product that is intended for the diagnosis, prevention or treatment of a life-threatening or a chronically debilitating condition affecting not more than five in 10,000 persons in the European Community when the application for designation is submitted. Orphan drug designation provides the sponsor with access to the Centralized Procedure for the application for marketing authorization, protocol assistance, up to a 100% reduction in fees related to a marketing authorization application, pre-authorization inspection and post-authorization activities, and could provide ten years of market exclusivity in the EU, once approved for the treatment of Multiple Myeloma.

The FDA may permit expedited development, evaluation, and marketing of new therapies intended to treat persons with serious or life-threatening conditions for which there is an unmet medical need under its fast track drug development programs. A sponsor can apply for fast track designation at the time of submission of an IND, or at any time prior to receiving marketing approval of the NDA. To receive fast track designation, an applicant must demonstrate that the drug:

- is intended to treat a serious or life-threatening condition;
- is intended to treat a serious aspect of the condition; and

has the potential to address unmet medical needs, and this potential is being evaluated in the planned drug development program.

Clinical testing must meet requirements for institutional review board oversight, informed consent and good clinical practices, and must be conducted pursuant to an IND, unless exempted.

For purposes of NDA approval, clinical trials are typically conducted in the following sequential phases:

Phase 1: The drug is administered to a small group of humans, either healthy volunteers or patients, to test for safety, dosage tolerance, absorption, metabolism, excretion, and clinical pharmacology.



Phase 2: Studies are conducted on a larger number of patients to assess the efficacy of the product, to ascertain dose tolerance and the optimal dose range, and to gather additional data relating to safety and potential adverse events.

Phase 3: Studies establish safety and efficacy in an expanded patient population.

Phase 4: The FDA may require Phase 4 post-marketing studies to find out more about the drug's long-term risks, benefits, and optimal use, or to test the drug in different populations, such as children.

The length of time necessary to complete clinical trials varies significantly and may be difficult to predict. Clinical results are frequently susceptible to varying interpretations that may delay, limit or prevent regulatory approvals. Additional factors that can cause delay or termination of our clinical trials, or that may increase the costs of these trials, include:

slow patient enrollment due to the nature of the clinical trial plan, the proximity of patients to clinical sites, the eligibility criteria for participation in the study or other factors, and the number of sites participating in the trial;

inadequately trained or insufficient personnel at the study site to assist in overseeing and monitoring clinical trials or delays in approvals from a study site's review board;

longer treatment time required to demonstrate efficacy or determine the appropriate product dose;

insufficient supply of the drug candidates;

adverse medical events or side effects in treated patients; and

ineffectiveness of the drug candidates.

In addition, the FDA may place a clinical trial on hold or terminate it if it concludes that subjects are being exposed to an unacceptable health risk. Any drug is likely to produce some toxicity or undesirable side effects when administered at sufficiently high doses and/or for a sufficiently long period of time. Unacceptable toxicity or side effects may occur at any dose level at any time in the course of studies designed to identify unacceptable effects of a drug candidate, known as toxicological studies, or clinical trials of drug candidates. The appearance of any unacceptable toxicity or side effect could bring us or regulatory authorities to interrupt, limit, delay or abort the development of any of our drug candidates and could ultimately prevent approval by the FDA or foreign regulatory authorities for any or all targeted indications.

Before receiving FDA approval to market a product, we must demonstrate that the product is safe and effective for its intended use by submitting to the FDA an NDA containing the pre-clinical and clinical data that have been accumulated, together with chemistry and manufacturing and controls specifications and information, and proposed labeling, among other things. The FDA may refuse to accept an NDA for filing if certain content criteria are not met and, even after accepting an NDA, the FDA may often require additional information, including clinical data, before approval of marketing a product.

As part of the approval process, the FDA must inspect and approve each manufacturing facility. Among the conditions of approval is the requirement that a manufacturer's quality control and manufacturing procedures conform to cGMP. Manufacturers must expend time, money and effort to ensure compliance with cGMP, and the FDA conducts periodic inspections to certify compliance. It may be difficult for our manufacturers or us to comply with the applicable cGMP and other FDA regulatory requirements. If we or our contract manufacturers fail to comply, then the FDA will not allow us to market products that have been affected by the failure.

If the FDA grants approval, the approval will be limited to those disease states, conditions and patient populations for which the product is safe and effective, as demonstrated through clinical studies. Further, a product may be marketed only in those dosage forms and for those indications approved in the NDA. Certain changes to an approved NDA, including, with certain exceptions, any changes to labeling, require approval of a supplemental application before the drug may be marketed as changed. Any products that we manufacture or distribute pursuant to FDA approvals are subject to continuing regulation by the FDA, including compliance with cGMP and the reporting of adverse experiences with the drugs. The nature of marketing claims that the FDA will permit us to make in the labeling and advertising of our products will be limited to those specified in an FDA approval, and the advertising of our products will be subject to comprehensive regulation by the FDA. Claims exceeding those that are approved will constitute a violation of the Federal Food, Drug, and Cosmetic Act. Violations of the Federal Food, Drug, and Cosmetic Act or regulatory requirements at any time during the product development process, approval process, or after approval may result in agency enforcement actions, including withdrawal of approval, recall, seizure of products, injunctions, fines and/or civil or criminal penalties. Any agency enforcement action could have a material adverse effect on our business.

Should we wish to market our products in countries other than the US, we must receive marketing authorization from the appropriate regulatory authorities. The requirements governing the conduct of clinical trials, marketing authorization, pricing and reimbursement vary widely from country to country. At present, companies are typically required to apply for foreign marketing authorizations at a national level. However, within the EU, registration procedures are available to companies wishing to market a product in more than one EU member state. Typically, if the regulatory authority is satisfied that a company has presented adequate evidence of safety, quality and efficacy, then the regulatory authority will grant a marketing authorization. This regulatory approval process, however, involves risks similar or identical to the risks associated with FDA approval discussed above, and therefore we cannot guarantee that we will be able to obtain the appropriate marketing authorization for any product in any particular country. Our current development strategy calls for us to seek marketing authorization for our drug candidates in countries other than the United States.

Failure to comply with applicable laws and regulations would likely have a material adverse effect on our business. In addition, laws and regulations regarding the manufacture and sale of new drugs are subject to future changes. We cannot predict the likelihood, nature, effect or extent of adverse governmental regulation that might arise from future legislative or administrative action.

#### **Organizational structure**

Our wholly-owned subsidiary, XTEPO, is an Israeli privately-held company incorporated in November 2009 for the execution of the Bio-Gal transaction and which holds the exclusive license of the use patent of rHuEPO drug for Multiple Myeloma.

Our wholly-owned subsidiary, XTL Biopharmaceuticals, Inc. and its wholly-owned subsidiary XTL Development, Inc., were each incorporated in Delaware. Since November 2008, these companies have not been active. Both companies were dissolved in 2014.

Our subsidiary, InterCure Ltd., is an Israeli public company, incorporated in November 1994. As of December 31, 2014, we held approximately 54.72% of InterCure's issued and outstanding ordinary shares. As of the date hereof, we hold approximately 5.82% of InterCure's issued and outstanding ordinary shares.

#### **Property, Plant and Equipment**

Since April 2015 we lease offices in Ra'anana, Israel. The basic lease period is for 24 months with an option for an additional 24-month period.

To our knowledge, there are no environmental issues that affect our use of the properties that we lease.

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

None.

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

You should read the following discussion and analysis in conjunction with our audited consolidated financial statements, including the related notes, prepared in accordance with IFRS (International Financial Reporting Standards) for the years ended December 31, 2014, 2013 and 2012, and as of December 31, 2014 and 2013, contained in “Item 18. Financial Statements” and with any other selected financial data included elsewhere in this annual report.

***Selected Financial Data***

The tables below present selected financial data for the fiscal years ended as of December 31, 2014, 2013 and 2012 and as of December 31, 2014 and 2013. The balance sheet information as of December 31, 2012 has been derived from audited financial statements not included elsewhere in this report. We have derived this selected financial data from our audited consolidated financial statements, included elsewhere in this report and prepared in accordance with IFRS issued by the IASB. You should read the selected financial data in conjunction with “Item 3. Key Information” and “Item 8. Financial Information” and “Item 18. Financial Statements.”

	Year ended December 31,		
	2014	2013	2012
	U.S. dollars in thousands		
	(except per share data)		
Research and development expenses	(278	) (82	) (92
General and administrative expenses	(1,744	) (1,329	) (2,448
Other gains, net	-	1,059	802
Operating loss	(2,022	) (352	) (1,738
Finance income	41	114	55
Finance expenses	(138	) (55	) (5
Finance income, net	(97	) 59	50
Earnings (loss) from investment in associate	-	(845	) 569
Total loss for the year	(2,119	) (1,138	) (1,119
Other comprehensive income (loss):			
Items that might be classified to profit or loss:			
Foreign currency translation adjustments	-	108	114
	-	(221	) -

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Reclassification of foreign currency translation adjustments to Other gains, net

Total other comprehensive income (loss)	-	(113	)	114
Total comprehensive loss from continuing operations	(2,119	)	(1,251	) (1,005
Total comprehensive loss from discontinued operations	(746	)	(2,575	) (623
Total comprehensive loss for the year	(2,865	)	(3,826	) (1,628
Total loss for the year attributable to:				
Equity holders of the Company	(2,527	)	(2,476	) (1,390
Non-controlling interests	(338	)	(1,237	) (352
	(2,865	)	(3,713	) (1,742
Total comprehensive loss for the year attributable to:				
Equity holders of the Company	(2,527	)	(2,589	) (1,276
Non-controlling interests	(338	)	(1,237	) (352
	(2,865	)	(3,826	) (1,628
Basic and diluted loss per share from continuing and discontinued operations (in U.S. dollars):				
From continuing operations	(0.009	)	(0.005	) (0.005
From discontinued operations	(0.002	)	(0.006	) (0.001
From loss for the period	(0.011	)	(0.011	) (0.006
Weighted average number of issued ordinary shares	231,224,512		223,605,181	217,689,926

## Consolidated Statements of Financial Position Data:

As of December 31,  
2014 2013 2012  
U.S dollars in thousands

Cash, cash equivalents and bank deposits	2,159	4,165	3,312
Working capital *)	2,102	3,870	2,143
Total assets	5,644	8,015	11,086
Long term liabilities	-	11	13
Total shareholders' equity	4,660	6,265	7,353
Non-controlling interests	19	520	2,071

\*) Working capital is defined as current assets less current liabilities.

## Overview

We are a biopharmaceutical company engaged in the acquisition and development of pharmaceutical products for the treatment of unmet medical needs, particularly the treatment of SLE, Multiple Myeloma and Schizophrenia.

We were established as a corporation under the laws of Israel in 1993, and commenced operations to use and commercialize technology developed at the Weizmann Institute, in Rehovot, Israel. Since commencing operations, our activities have been primarily devoted to developing our technologies and drug candidates, acquiring pre-clinical and clinical-stage compounds, raising capital, purchasing assets for our facilities, and recruiting personnel. We are a development stage company. We have had no drug product sales to date and the sales of our medical devices are as yet insufficient to generate operating income. Our major sources of working capital have been proceeds from various private placements of equity securities, option and warrant exercises, our initial public offering, our placing and open offer transaction, and private investments in public equities.

We have incurred negative cash flow from operations each year since our inception and we anticipate incurring negative cash flows from operating activities for the foreseeable future. We have spent, and expect to continue to spend, substantial amounts in connection with implementing our business strategy, including our planned product development efforts, our clinical trials, marketing efforts of our medical devices and potential in-licensing and acquisition opportunities.

Our research and development expenses in 2014, 2013 and 2012 primarily consisted of expenses related to the hCDR1 and rHuEPO development plan. As part of the preparations for hCDR1 in 2014, the Company engaged regulatory and clinical consultants and commenced work on Chemistry, Manufacturing and Control, or CMC, including production

and testing of the drug substance. As part of the preparations for rHuEPO, the Company engaged regulatory consultants and conducted research which includes collection of data relating to the level of specific proteins in the blood of a group of patients with Multiple Myeloma, which will assist in focusing the Phase 2 clinical trial protocol. This collected research data will be integrated in the Phase 2 clinical trial. The costs of such preparations comprise of, among other things, costs in connection with medical regulation, medical consulting costs and payments to medical centers. Additionally, we had expenses for the amortization of the exclusive right to examine a medical technology in the field of the immune system in 2010 and 2011.



Our general and administrative expenses consist primarily of salaries, consultant fees, and related expenses for executive, finance and other administrative personnel, professional fees, director fees and other corporate expenses, including investor relations, business development costs and facilities related expenses. We expense our general and administrative expenses as incurred.

Our results of operations include non-cash compensation expense as a result of the grants of XTL stock options. Compensation expense for awards of options granted to employees and directors represents the fair value of the award (measured using the Black-Scholes valuation model) recorded over the respective vesting periods of the individual stock options (see details below.)

For awards of options and warrants to consultants and other third-parties, according to IFRS 2, the treatment of such options and warrants is the same as employee options compensation expense (see note 20 to the consolidated financial statements). We record compensation expense based on the fair value of the award at the grant date according to the Black-Scholes valuation model. According to the IFRS 2, in non-performance-based options, the Company recognizes options expenses using the graded vesting method (accelerated amortization). Graded vesting means that portions of a single option grant will vest on several dates, equal to the number of tranches. The Company treats each tranche as a separate share option grant; because each tranche has a different vesting period, and hence the fair value of each tranche is different. Therefore, under this method the compensation cost amortization is accelerated to earlier periods in the overall vesting period.

Our planned clinical trials will be lengthy and expensive. Even if these trials show that our drug candidates are effective in treating certain indications, there is no guarantee that we will be able to record commercial sales of any of our product candidates in the near future or generate licensing revenues from upfront payments associated with out-licensing transactions. In addition, we expect losses in our drug development activity to continue as we continue to fund development of our drug candidates. As we continue our development efforts, we may enter into additional third-party collaborative agreements and may incur additional expenses, such as licensing fees and milestone payments. As a result, our periodical results may fluctuate and a period-by-period comparison of our operating results may not be a meaningful indication of our future performance.

## Results of Operations

### *Years Ended December 31, 2014 and 2013*

*Research and Development Expenses.* Research and development expenses in the years ended December 31, 2014 and 2013 totaled approximately \$278,000 and \$82,000, respectively. Research and development expenses are comprised mainly of expenses related to preparations for initiating the phase 2 clinical trials of the hCDR1 and rHuEPO drugs designed to treat SLE and Multiple Myeloma patients, respectively. The increase in expenses in 2014 compared to 2013 is mainly due to expenses related to the Company's hCDR1 drug, in-licensed In January 2014.

*General and Administrative Expenses.* General and administrative expenses for the years ended December 31, 2014 and 2013 totaled approximately \$1,744,000 and \$1,329,000, respectively. The increase in 2014 compared to 2013 is mainly due to a \$0.5 million decrease in share-based payments to directors, service providers and employees, resulting from a reversal of expenses in 2013 due to forfeitures of stock options by a director who resigned from the Company.

*Other gains (losses), net.* Other gains in the year ended December 31, 2013 totaled approximately \$1,059,000, primarily originating from a gain from the sale of the Company's investment in Proteologics which totaled approximately \$1,051,000. In the year ended December 31, 2012, the other gains in the amount of \$802,000 were mainly due to a bargain purchase in connection with the InterCure transaction totaling \$795,000. Bargain purchase gain is the excess of the fair value of the investment acquired over the fair value of the consideration provided for such purchase in accordance with IFRS 3R, "Business Combinations (Revised)" ("**IFRS3R**"), as further detailed below.

*Finance income (expenses), net.* Finance income (expenses), net for the years ended December 31, 2014 and 2013 totaled approximately (\$97,000) and \$59,000, respectively. The decrease in finance income in 2014 compared to 2013 derives mainly from a significant increase in the NIS/USD exchange rate during 2014.

*Earnings (losses) from investment in associate.* Earnings (losses) from investment in associate totaling approximately (\$845,000) and \$569,000 in the years ended December 31, 2013 and 2012, respectively, arose from the Company's investment in Proteologics which was accounted for according to the equity method. During 2013, the Company recognized such losses due to operational losses in Proteologics. From the acquisition date of November 21, 2012 through December 31, 2012, the Company's share in Proteologics' losses totaled approximately \$144,000. On the date of acquisition, the Company recorded a gain from a bargain purchase totaling approximately \$713,000.

Total loss from discontinued operations. Total loss from discontinued operations totaled approximately \$746,000 and \$2,575,000, and represents InterCure's net results for the years ended December 31, 2014 and 2013, respectively. Such loss in 2013 includes an impairment of \$1.7 million in intangible assets recognized in the acquisition of InterCure in 2012.

*"Income Taxes"* We had no income tax expense for the years ended December 31, 2014 and 2013 due to losses incurred and we did not recognize any deferred tax benefits, since it is not "more likely than not" that we will be able to generate profits in the future to realize the deferred taxes.

### ***Years Ended December 31, 2013 and 2012***

*Research and Development Expenses.* Research and development expenses in the years ended December 31, 2013 and 2012 totaled approximately \$82,000 and \$92,000, respectively. Research and development expenses are comprised mainly of expenses related to preparations for initiating the phase 2 clinical trials of the rHuEPO drug designed to treat cancer patients with Multiple Myeloma and include, among other things, research costs incurred in tracing blood proteins in Multiple Myeloma patients, costs in connection with medical regulation, clinical insurance costs and other medical consulting costs. The increase in expenses in 2013 compared to 2012 is mainly due to expenses related to the Company's rHuEPO and SAM-101 drugs.

*General and Administrative Expenses.* General and administrative expenses for the years ended December 31, 2013 and 2012 totaled approximately \$1,329,000 and \$2,448,000, respectively. The decrease in 2013 compared to 2012 is mainly due to a \$1.1 million decrease in share-based payments to directors, service providers and employees, originating from lower stock option grants in 2013, as well as reversal of expenses due to forfeitures of stock options by a Director who resigned from the Company.

*Other gains (losses), net.* Other gains in the year ended December 31, 2013 totaled approximately \$1,059,000, primarily originating from a gain from the sale of the Company's investment in Proteologics which totaled approximately \$1,051,000. In the year ended December 31, 2012, the other gains in the amount of \$802,000 were mainly due to a bargain purchase in connection with the InterCure transaction totaling \$795,000. Bargain purchase gain is the excess of the fair value of the investment acquired over the fair value of the consideration provided for such purchase in accordance with IFRS3R.

*Finance income, net.* Finance income, net for the years ended December 31, 2013 and 2012 totaled approximately \$59,000 and \$50,000, respectively. The decrease in finance income in 2013 compared to 2012 derives mainly from lower interest income on short-term bank deposits whose carrying amount during 2012 was significantly higher compared to 2013 as a result of the capital raising completed by the Company in March 2012 in a private placement and from the exercise of warrants (series 2) in the period. This decrease was partially offset by an increase in finance income from exchange rate differences, owing to larger NIS-denominated balances originating from proceeds from the sale of the investment in Proteologics.

*Earnings (losses) from investment in associate.* Earnings (losses) from investment in associate totaling approximately (\$845,000) and \$569,000 in the years ended December 31, 2013 and 2012, respectively, arose from the Company's investment in Proteologics which was accounted for according to the equity method. During 2013, the Company recognized such losses due to operational losses in Proteologics. From the acquisition date of November 21, 2012 through December 31, 2012, the Company's share in Proteologics' losses totaled approximately \$144,000. On the date of acquisition, the Company recorded a gain from a bargain purchase totaling approximately \$713,000.

*"Income Taxes"* We had no income tax expense for the years ended December 31, 2013 and 2012 due to losses incurred and we did not recognize any deferred tax benefits, since it is not "more likely than not" that we will be able to generate profits in the future to realize the deferred taxes.

## **Significant Accounting Policies**

*Basis of presentation of the financial statements.* The financial statements of the Company and its subsidiaries (the "**Group**") as of December 31, 2014 and 2013, and for each of the three years in the period ended December 31, 2014 have been prepared in accordance with International Financial Reporting Standards which are standards and interpretations issued by the International Accounting Standards Board ("**IFRS**").

The significant accounting policies described below are consistent with those of all periods presented, unless indicated otherwise.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires the Company's management to exercise its judgment in the process of applying the Group's accounting policies. The areas that involve judgment which has significant effect or complexity or where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3 to the annual consolidated financial statements. Actual results could significantly differ from the estimates and assumptions used by the Group's management.

The Company analyzes the expenses recognized in the statement of comprehensive income by classification based on the function of expense.

We define critical accounting policies as those that are reflective of significant judgments and uncertainties and which may potentially result in materially different results under different assumptions and conditions. In applying these critical accounting policies, our management uses its judgment to determine the appropriate assumptions to be used in making certain estimates. These estimates are subject to an inherent degree of uncertainty. Our critical accounting policies include the following:

*Subsidiaries consolidation and business combinations*

The consolidated financial statements include the accounts of the Company and entities controlled by the Company. Control exists when the Company has the power over the investee, has exposure, or rights, to variable returns from involvement in the investee, and has the ability to use its power over the investee to affect its returns.

The Company examines whether it controls another entity even when it does not hold more than 50% of the voting rights, but can control the entity's financial and operating policies by de-facto control. De-facto control can be created under circumstances in which the ratio of the Company's voting rights in the entity to the percentage and dispersion of the holdings of the other shareholders grants the Company the power to control the entity's financial and operating policies.

Subsidiaries are fully consolidated starting from the date on which control therein is attained by the Company. Their consolidation ceases when such control is discontinued.

Intra-group balances and transactions, including revenues, expenses and dividends in respect of transactions between the Group companies, are eliminated. Gains and losses arising from intra-group transactions that have been recognized as assets (such as inventories and property, plant and equipment) are also eliminated. Such intra-group losses may point to the impairment of assets which is tested and accounted for as specified in g below.

Transactions with non-controlling interests in subsidiaries which do not result in loss of control in the subsidiaries are accounted for as transactions with owners. In these transactions, the difference between the fair value of any consideration paid or received and the amount of adjustment of the non-controlling interests to reflect the changes in their relative rights in the subsidiaries is directly recognized in equity and attributed to the equity holders of the parent.

#### *Associate*

An associate is an entity over which the Group exercises significant influence, but not control, which is usually expressed in holding 20%-50% of the voting rights. The investment in an associate is presented using the equity method of accounting. According to the equity method of accounting, the investment is initially recognized at cost and its carrying amount varies to the extent that the Group recognizes its share of the associate's earnings or losses from the acquisition date.

The Group's share in the earnings or losses of associates after the acquisition date is carried to profit or loss and its share in the other comprehensive income movements after the acquisition date is carried to other comprehensive income against the carrying amount of the investment.

*Intangible assets*

1. Brand name and technology:

Brand name and technology acquired in a business combination are recognized at fair value on the acquisition date. Brand name and technology have a finite useful life and are presented at cost net of accumulated amortization and impairment losses. The amortization is calculated using the straight-line method over the expected useful life (9-10 years).

2. Computer software:

Acquired licenses to use computer software are capitalized based on costs incurred in acquiring the specific software and preparing it for use. These costs are amortized using the straight-line method over the estimated useful life (five years). Costs relating to computer software upkeep are recognized as expenses as incurred.

3. Unamortized intangible assets (licenses and patent rights)

The amortization of an asset on a straight-line basis over its useful life begins when the development procedure is completed and the asset is available for use. These assets are reviewed for impairment once a year or whenever there are indicators of a possible impairment, in accordance with the provisions of IAS 36, "Impairment of Assets".

4. Research and development

Research expenditures are recognized as expenses when incurred. Costs arising from development projects are recognized as intangible assets when the following criteria are met:

- it is technically feasible to complete the intangible asset so that it will be available for use;
- management intends to complete the intangible asset and use or sell it;
- there is an ability to use or sell the intangible asset;

- it can be demonstrated how the intangible asset will generate probable future economic benefits;

adequate technical, financial and other resources to complete the development and to use or sell the intangible asset are available; and

- the expenditure attributable to the intangible asset during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognized as an expense when incurred.

Development costs that were previously recognized as an expense are not recognized as an asset in a later period.

During the three years ended December 31, 2014, the Group did not capitalize development costs to intangible assets.

#### *Impairment of non-financial assets*

Intangible assets which are not yet available for use are not depreciated and impairment in their respect is tested every year. Depreciable 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. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that sustained impairment are reviewed for possible reversal of the impairment at each date of the statement of financial position.

As for testing impairment of acquired intangible assets, see *intangible assets* above.



*Share-based payment*

The Group operates a number of share-based payment plans to employees and to other service providers who render services that are similar to employees' services that are settled with the Group's equity instruments. In this framework, the Group grants employees, from time to time, and at its sole discretion, options to purchase shares of the Group companies. The fair value of services received from employees in consideration of the grant of options is recognized as an expense in the statement of comprehensive income (loss) and correspondingly carried to equity. The total amount recognized as an expense over the vesting term of the options (the term over which all pre-established vesting conditions are expected to be satisfied) is determined by reference to the fair value of the options granted at grant date, except the effect of any non-market vesting conditions.

Non-market vesting conditions are included in the assumptions used in estimating the number of options that are expected to vest. The total expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions of the share-based payment arrangement are to be satisfied.

In each reporting date, the Company revises its estimates of the number of options that are expected to vest based on the non-market vesting conditions and recognizes the impact of the revision to original estimates, if any, in the statement of comprehensive income (loss) with a corresponding adjustment in equity.

When the options are exercised, the Company issues new shares. The proceeds net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium.

Share-based payment transactions in which the Company acquired assets as consideration for the Company's equity instruments are measured at the value of the assets acquired.

*Revenue recognition*

Revenues are recognized in profit or loss when the revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company, and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Revenues are measured at the fair value of the consideration received less any trade discounts, volume rebates and returns.

Following are the specific revenue recognition criteria which must be met before revenue is recognized:

*Revenues from sale of goods to retail customers:*

Revenues from the sale of goods are recognized when all the significant risks and rewards of ownership of the goods have passed to the buyer and the seller no longer retains continuing managerial involvement. The delivery date to the customer is usually the date on which ownership passes.

*Revenues from sale of goods to distributors:*

InterCure sells its products to distributors as well. Revenues from such sales are recognized when InterCure or its subsidiaries deliver the goods to the distributor, when sales channel and selling price are at the distributor's sole discretion, and when there are no ongoing obligations to prevent the distributor from receiving the goods. Revenue is only recognized when goods were delivered to the designated site, risks of loss and damage are transferred to the distributor and distributor had received the goods in accordance with the sales agreement, conditions for receipt of goods had expired or InterCure holds objective evidence that goods receipt criteria had been met.

Sales do not include a finance component, as they are made with a 60 days credit period, considered as consistent with the market in which InterCure operates.

*Discontinued operations*

A discontinued operation is a component of an entity that either has been disposed of, or is classified as held for sale, and represents a separate major line of business or geographical area of operations, or is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale.

Revenues and expenses attributable to discontinued operations are presented in the statement of comprehensive loss under the item "*Total loss from discontinued operations*", for all years presented.

## Critical Accounting Estimates and Judgments

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

### 1. Critical accounting estimates and assumptions

Accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

#### Intangible assets

(i) In testing impairment of research and development assets, the Company's management is required to estimate, among other things, the probable endpoints of trials conducted by the Company, the commercial technical feasibility of the development and the resulting economic benefits. Actual results and estimates to be made in the future may significantly differ from current estimates.

(ii) The Group is required to determine at the end of each reporting period whether there is any indication that an asset may be impaired. If indicators for impairment are identified, the Group estimates the assets' recoverable amount, which is the higher of an asset's fair value less costs to sell and its value-in-use. The value-in-use calculations require management to make estimates of the projected future cash flows. Determining the estimates of the future cash flows is based on management past experience and best estimate for the economic conditions that will exist over the remaining useful economic life of the CGU.

Share-based payments – in evaluating the fair value and the recognition method of share-based payment, the Company's management is required to estimate, among others, different parameters included in the computation of the fair value of the options and the Company's results and the number of options that will vest.

### 2. Judgments that have a critical effect on the adoption of the entity's accounting policies:

The existence of control over InterCure – As of December 31, 2014, and effective as of May 16, 2013, the Company held 54.72% of InterCure's issued and outstanding share capital, following the conversion of the loan granted to InterCure into 7,620,695 shares of InterCure. In the reporting period ended December 31, 2012, the Group's management had estimated the degree of effect it had in InterCure and had determined that it was able to govern InterCure's financial and operating policies despite holding less than 50% of InterCure's issued and outstanding share

capital at the time, through de-facto control, this following an examination of InterCure's entire equity instruments. This conclusion was reached mainly since the Company was able to convert the aforementioned loan into shares of InterCure, a conversion which will have conferred the Company a stake of approximately 54.72% of InterCure's issued and outstanding share capital.

After the reporting period, events pertaining to the investment in InterCure reduced the Company's stake in InterCure to 5.82%. Considering the Company's diluted voting rights in InterCure and the termination of a voting agreement signed between the Company and Green Forest Global Ltd., under which each of the two parties will appoint two directors of the total of seven directors to the board of directors of InterCure, the Company's management determined that a loss of control in InterCure occurred during the first quarter of 2015.

### **Impact of Inflation and Currency Fluctuations**

We generate most of our revenues and hold most of our cash, cash equivalents and bank deposits in US dollars. While a substantial amount of our operating expenses are in US dollars, we incur a portion of our expenses in New Israeli Shekels. In addition, we also pay for some of our services and supplies in the local currencies of our suppliers. As a result, we are exposed to the risk that the US dollar will be devalued against the New Israeli Shekel or other currencies, and as result our financial results could be harmed if we are unable to protect against currency fluctuations in Israel or other countries in which services and supplies are obtained in the future. Accordingly, we may enter into currency hedging transactions to decrease the risk of financial exposure from fluctuations in the exchange rates of currencies. The Company's treasury's risk management policy, excluding InterCure, is to hold NIS-denominated cash and cash equivalents and short-term deposits in the amount of the anticipated NIS-denominated liabilities for six consecutive months from time to time in line with the directives of the Company's Board. InterCure focuses on actions to reduce to a minimum the negative effects arising from this risk and therefore holds cash and cash equivalents in currencies in which it operates, in accordance with management's assessments. These measures, however, may not adequately protect us from the adverse effects of inflation in Israel. In addition, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the New Israeli Shekel in relation to the US Dollar or that the timing of any devaluation may lag behind inflation in Israel. Future activities may lead us to perform a clinical trial in Israel, which may lead us to reassess our use of the US dollar as our functional currency.

As of December 31, 2014, had the Group's functional currency weakened by 10% against the NIS with all other variables remaining constant, post-tax loss for the year would have been \$ 85,000 lower (2013 – post-tax loss approximately \$ 157,000 lower; 2012 - post-tax loss approximately \$ 89,000 lower), mainly as a result of exchange rate changes on translation of other accounts receivable, net and exchange rate changes on NIS-denominated cash and cash equivalents and short-term deposits. Loss was more sensitive to movement in the exchange rate in relation to the NIS in 2014 than in 2013 mainly because of the decreased amount of the NIS-denominated balances in the items of cash, receivables and payables of the Group, as December 31, 2013 balances included NIS denominated receivables from the sale of Proteologics.

### **Governmental Economic, Fiscal, Monetary or Political Policies that Materially Affected or Could Materially Affect Our Operations**

The income of the Company is subject to corporate tax at the regular rate; the guidance of the amendment to the Israeli Income Tax Ordinance, 2005 from August 2005 prescribes a gradual reduction in the corporate tax rates and the resulting corporate tax rates starting 2009 are as follows: 2009 - 26% and 2010 and thereafter - 25%.

On July 14, 2009, the "Knesset" (Israeli Parliament) passed the Law for Economic Efficiency (Amended Legislation for Implementing the Economic Plan for 2009 and 2010), 2009, which prescribes, among other things, an additional gradual reduction in the corporate tax rates starting 2011 to the following tax rates: 2011 - 24%, 2012 - 23%, 2013 -

22%, 2014 - 21%, 2015 - 20%, 2016 and thereafter - 18%.

In December 2011, following the enactment of the Law for the Changing the Tax Burden (Legislative Amendments), 2011 (hereafter – “Tax Burden Distribution Law”), the phased reduction in the corporate tax was eliminated, and corporate tax rate in 2012 and thereafter was set to 25%.

On August 5, 2013, the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013-2014), 2013 (the “Law”) was published in the Government’s records. The Law prescribes, among other things, the Law prescribes from the 2014 tax year and thereafter, an increase in the Israeli corporate tax rate to 26.5% (instead of 25%).

As of December 31, 2014, XTL Biopharmaceuticals Ltd. did not have any taxable income, except for a capital gain from the sale of the investment in Proteologics, which was offset against capital loss carryforwards and current operating losses. As of December 31, 2014, our net operating loss carry forwards for Israeli tax purposes registered on behalf of XTL Biopharmaceuticals Ltd. amounted to approximately \$ 27 million. Under Israeli law, these net-operating losses may be carried forward indefinitely and offset within XTL Biopharmaceuticals Ltd only, against future taxable income, including capital gains from the sale of assets used in the business, with no expiration date.

In order to obtain tax exemption for the share swap transaction with Bio-Gal pursuant to Sections 104 and 103 to the Israeli Income Tax Ordinance (Revised), 1961, we signed an agreement with the Israeli Tax Authority on July 15, 2010. Below is the summary of the principal conditions for the share swap and the transfer of the intangible asset:

1. The balance of the Company's business losses and capital losses for tax purposes was reduced to approximately NIS 80 million (approximately \$ 23 million) and approximately NIS 0.7 million (approximately \$ 0.2 million), respectively. This item is not to derogate from the Tax Assessing Officer's authority to establish that the balance of losses is actually lower than the abovementioned amounts.

2. Any losses incurred by the Company prior to the share swap, after their reduction as discussed in paragraph 1 above, will not be offset against any income originating from Xtepo (the transferred company) or against a capital gain from the sale of shares of Xtepo.

3. Xtepo shareholders will not be allowed to sell their shares in the Company for a period of two years from the end of the year of completion of the transaction ("the Lock-up Period"), subject to any changes in legislation.

4. The Company and Xtepo both undertake to maintain their main economic activity as it was prior to the transaction during the Lock-up Period.

5. The Company will not be permitted to sell its holdings in Xtepo for the duration of the Lock-up Period.

The Lock-up Period ended on December 31, 2012.

It is indicated that the guidance to Sections 104 and 103 to the Israeli Income Tax Ordinance which deal with restructuring and mergers impose statutory limitations and various conditions on the entities participating in the change in structure/merger, among other things, restrictions on dilution of holdings from raising by a prospectus or by private placements. The summary of the principles detailed above does not constitute a substitute to the overall articles.

Additionally, on January 1, 2013, Xtepo shareholders decided to engage in a new voluntary lock-up agreement ("New Lock-Up Agreement") for an additional period of 3 years ("New Restriction Period"), according to which selling restrictions shall apply to the shares held by them. Hereunder are the principle restrictions regarding the quantities eligible for sale during the agreement period:

1. During the first year of the New Restriction Period (starting on January 1, 2013 up to December 31, 2013) 15% of the total shares held by Xtepo shareholders shall be eligible for sale in a manner that every month each shareholder shall be entitled to sell up to 1.25% ( $15\% * 1/12$ ) of the total restricted shares.

2. During the second year of the New Restriction Period (starting on January 1, 2014 up to December 31, 2014) shares that constitute 25% of the total amount of shares held by Xtepo shareholders shall be eligible for sale in a manner

that every month each shareholder shall be entitled to sell up to 2.08333% ( $25\% \times 1/12$ ) of the total restricted shares.

During the third year of the New Restriction Period (starting on January 1, 2015 up to December 31, 2015) the 3 remaining shares held by Xtepo shareholders shall be eligible for sale in a manner that every month each shareholder shall be entitled to sell up to 5% ( $60\% \times 1/12$ ) of the total restricted shares.

The New Lock-up Agreement terminates upon the occurrence of one of the following events: (1) the end of the New Restriction Period as defined above; (2) the shareholders receipt of written notification from the Trustee that the Trustee wishes to terminate their position under the New Lock-Up Agreement within 30 days, and the Company has not found a replacement trustee within the said period; or (3) a majority of the shareholders who are party to the New Lock-Up Agreement agree to terminate the agreement.

Since April 7, 2009, we have not had a “permanent establishment” or activity in the US, and our subsidiaries do not perform any activities in the US. Our board of directors consists of a majority of Israeli residents and our management is domiciled in Israel.



## **B. Liquidity and Capital Resources**

We have financed our operations from inception primarily through various private placement transactions, our initial public offering, a placing and open offer transaction, option and warrant exercises, and private investments in public equities. As of December 31, 2014, we had received net proceeds of approximately \$80.2 million from various private placement transactions, including net proceeds of approximately \$1.5 million from the Bio-Gal transaction in August 2010, net proceeds of approximately \$45.7 million from our initial public offering in September 2000, net proceeds of approximately \$15.4 million from the 2004 placing and open offer transaction, net proceeds of approximately \$1.75 million from our public offering on TASE in March 2011, net proceeds of approximately \$3.4 million from our public offering on Nasdaq in April 2015, and proceeds of approximately \$4.0 million from the exercise of options and warrants.

The discussion of our liquidity and capital resources below excludes any balances in InterCure, as it is considered a discontinued operation as of December 31, 2014.

As of December 31, 2014, we had approximately \$2.2 million in cash, cash equivalents, and short-term bank deposits, a decrease of \$1.7 million from December 31, 2013.

Cash flows used in operating activities for the year ended December 31, 2014 totaled approximately \$2.0 million, compared to cash flows used in operating activities of approximately \$1.5 million for the year ended December 31, 2013. The increase in cash used in operating activities compared to the corresponding period last year mainly arises from an increase in research and development and fundraising activities.

Cash flows provided by investing activities in the year ended December 31, 2014 totaled approximately \$1.5 million compared to cash flows provided by investing activities of approximately \$3.3 million in the previous year. Cash flows in 2013 mainly originated from the sale of Proteologics. Activities in 2014 included withdrawal of short-term deposits in a total amount of \$1.2 million, as well as receipt of the final payment from the sale of Proteologics in the amount of \$0.3 million.

Cash flows provided by financing activities in the year ended December 31, 2014 totaled approximately \$0.3 million compared to cash flows provided by investing activities of approximately \$0.3 million in the previous year. Amount for both periods mostly reflect the sale of treasury shares held by InterCure.

The Company has incurred continuing losses and depends on outside financing resources to continue its activities. Based on existing business plans, the Company's management estimates that its outstanding cash and cash equivalent balances, including short-term deposits, will allow the Company to finance its activities for an additional period of at least 12 months from the date of this report. However, the amount of cash which the Company will need in practice to finance its activities depends on numerous factors which include, but are not limited to, the timing, planning and execution of clinical trials of existing drugs and future projects which the Company might acquire or other business development activities such as acquiring new technologies and/or changes in circumstances which are liable to cause significant expenses to the Company in excess of management's current and known expectations as of the date of these financial statements and which will require the Company to reallocate funds against plans, also due to circumstances beyond its control.

The Company expects to incur additional losses in 2015 arising from research and development activities, testing additional technologies and operating activities, which will be reflected in negative cash flows from operating activities. In order to perform the clinical trials aimed at developing a product until obtaining its marketing approval, the Company may be required to raise additional funds in the future by issuing securities. Should the Company fail to raise additional capital in the future under standard terms, it will be required to minimize its activities or sell or grant a sublicense to third parties to use all or part of its technologies.

### **C. Research and Development, Patents and Licenses**

Research and development costs in 2014, 2013 and 2012 substantially derived from costs related to the hCDR1 and rHuEPO development plan. As part of the preparations for hCDR1 in 2014, the Company engaged regulatory and clinical consultants and commenced work on CMC, including production and testing of the drug substance. As part of the preparations for rHuEPO, the Company engaged regulatory consultants and conducted a study which consists of collecting preliminary data on the existence of specific proteins in the blood of a group of Multiple Myeloma patients. The Company expanded the study to additional centers in order to collect additional data beyond the original study plan. The data which was collected in the framework of the preliminary study will be combined, as necessary, in planning and preparing for the implementation of the phase 2 clinical trial which the Company expects to obtain the approval to commence it in the second half of 2015. The costs of such preparations comprise of, among other things, costs in connection with medical regulation, patent registration costs, medical consulting costs and payments to medical centers. Additionally, we had amortization expenses of the exclusive right to examine a medical technology in the field of the immune system in 2011.

#### ***hCDR1 for the Treatment of SLE***

The Company intends to initiate a new Phase II clinical trial, which will include the 0.5 mg (and a 0.25 mg) weekly dose. We estimate that the trial will take one year to enroll patients, another year to conduct treatment, and additional time to analyze the results for a total of approximately two and a half years.

#### ***rHuEPO for the Treatment of Multiple Myeloma***

According to the clinical trial's preliminary plan received as part of the Bio-Gal transaction, we are planning on performing a prospective, multi-center, open-label, phase 2 study intended to assess safety of rHuEPO when given to patients with advanced Multiple Myeloma and demonstrate its effects on survival, biological markers related to the disease, immune improvements and quality of life. We intend to receive approval to commence such trial in the second half of 2015. We have not yet submitted the preliminary plan, which may be updated, to the authorities and/or the applicable IRB.

While we have begun preliminary discussions with the FDA, potential clinical sites, drug suppliers and third party vendors for the planned study, we have not yet determined the final size and scope of the study, and as a result, we cannot certify the above estimations regarding the clinical trial period and cost to complete the study.

*SAM-101 for the Treatment of Schizophrenia*

According to the preliminary development plan received as part of the MinoGuard transaction, it was planned to perform a multi-center phase 2b clinical trial under the FDA, using our proprietary combination. This preliminary plan is subject to changes in accordance with our regulatory advisors and the FDA/other regulatory agencies' requirements.

The information above provides estimates regarding the costs associated with the current estimated range of the time that will be necessary to complete the development phase for hCDR1 for the treatment of SLE, rHuEPO for the treatment of Multiple Myeloma and develop SAM-101 for the treatment of Schizophrenia.

The following table sets forth the research and development costs for the years 2014, 2013 and 2012 including all costs related to the clinical-stage projects, our pre-clinical activities, and all other research and development. We in-licensed hCDR1 in January 2014 and started preparations for clinical development of this asset during the year. We started preparations for rHuEPO clinical development in the last quarter of 2010 (after the completion of the Bio-Gal transaction on August 2010). We in-licensed SAM-101 in November 2011 and we estimate that we will incur significant costs on its development in the upcoming years. Whether or not and how quickly we commence and complete development of our clinical stage projects is dependent on a variety of factors, including the rate at which we are able to engage clinical trial sites and the rate of enrollment of patients. As such, the costs associated with the development of our drug candidates will probably increase significantly.

	Research and development Expenses in thousand US\$		
	Year ended December 31,		
	2014	2013	2012
hCDR1	206	9	-
rHuEPO	37	57	92
SAM-101	25	16	-
Other	10		
Total Research and Development	278	82	92

#### **D. Trend Information**

Please see “Item 5. Operating and Financial Review and Prospects” and “Item 4. Information on the Company” for trend information.

#### **E. Off-Balance Sheet Arrangements**

We have not entered into any transactions with unconsolidated entities whereby we have financial guarantees, subordinated retained interests, derivative instruments or other contingent arrangements that expose us to material continuing risks, contingent liabilities, or any other obligations under a variable interest in an unconsolidated entity that provides us with financing, liquidity, market risk or credit risk support.

#### **F. Tabular disclosure of contractual Obligations**

As of December 31, 2014, we had known contractual obligations, commitments and contingencies of approximately \$53,000 which relate to lease obligations for our offices, all of which is due within the next year. In April 2015, we signed an operational lease agreement for our new offices in Ra’anana. Under the new lease agreement, we will pay a monthly rent of approximately \$1,000.

We do not carry any contractual obligations, commitments or contingencies relates to research and development operations.

Payment due by period as of December 31, 2014 (in thousands of US\$)		
Contractual obligations	Total	Less than 1 year
Operating lease obligations	53	53
Total	53	53

Pursuant to our asset purchase agreement to acquire the rights to develop rHuEPO for the treatment of Multiple Myeloma from Bio-Gal Ltd., we are obligated to pay 1% royalties on net sales of the product, as well as a fixed royalty payment in the total amount of \$350,000 upon the successful completion of Phase 2. The payment of \$350,000 is to be made to Yeda upon the earlier of (i) six months from the successful completion of Phase 2 or (ii) the completion of a successful fundraising by XTL at any time after the completion of the Phase 2 in an amount of at least \$2 million.

According to the agreement with MinoGuard we are obligated to pay milestone payments to MinoGuard of up to \$2.5 million based on development and marketing milestones as well as 3.5% royalty of our net sales of the product and 7.5%-20% from our third-party out-license receipts, depending on the phase of the drug at the time of an out-license transaction. In addition to the above payments, and in accordance with the above agreement, since as of June 30, 2013, XTL had not commenced a phase 2 clinical trial, we were obligated to pay MinoGuard an annual license fee representing a value of \$45,000, for the 12 month period between July 1, 2013 and June 30, 2014. On September 3, 2014, we issued an additional 889,822 ordinary shares, representing a value of \$135,000, for the 12 month period between July 1, 2014 and June 30, 2015. Such annual payments will increase by \$90,000 per annum, up to \$675,000 for the eighth year of license or until the agreement is terminated.

It should be noted we have the sole discretion to pay any of the above amounts in cash or by way of issuing of our shares to MinoGuard.

According to our strategic collaboration master agreement with the Institute and Mor, we are obligated to pay the Institute for the services provided by them the cost basis related to the Institute’s activity in the framework of any project plus an additional 10% of the total royalties to which Mor is entitled pursuant to its agreements with the Company in connection with each technology for which rights were granted to the Company.

According to the licensing agreement signed with Yeda to develop hCDR1, a Phase II-ready asset for the treatment of Systemic Lupus Erythematosus (“SLE”). The terms of the licensing agreement include, among other things, expense reimbursement for patent expenses payable in six installments, certain milestone payments to Yeda, low single-digit royalties based on net sales, and additional customary royalties to the Office of the Chief Scientist.

## Item 6. Directors, Senior Management and Employees

### A. Directors and Senior Management

B. The following sets forth information with respect to our directors and executive officers as of the date hereof.

Name	Age	Position
David Bassa	53	Chairman of the Board of Directors
Osnat Hillel Fain	49	Non-Executive and External Director
Oded Nagar	46	Non-Executive and External Director
Doron Turgeman	47	Non-Executive Director
Shlomo Shalev	53	Non-Executive Director
Dr. Jonathan Schapiro	54	Non-Executive Director
Dr. Dobroslav Melamed	37	Non-Executive Director
Josh Levine	50	Chief Executive Officer
David Kestenbaum	51	Chief Financial Officer
Prof. Moshe Mittelman	62	Medical Director

David Bassa has served as a director in our company since November 2013. He is the CEO and co-founder of Sela Software Ltd., a leading knowledge center and software house for the high-tech and IT industry, since 1990. In 2000, Mr. Bassa founded Bio-Gal, a biopharmaceuticals company which subsequently merged into XTL, for the purpose of developing Erythropoietin (EPO) for the treatment of Multiple Myeloma. Mr. Bassa graduated with a B.A in Economics from Bar-Ilan University and an M.Sc in Computer Science studies (without thesis), also from Bar-Ilan University. Mr. Bassa was twice awarded the President Excellency Award (1981, 2002) and managed the Israeli branch of the international AIESEC organization, of which he is a Hall of Fame member.

Osnat Hillel Fain joined our Board of Directors in March 2015. She most recently served as Founder, Director and Managing Partner of Newton Propulsion Technologies LTD. In addition to serving as a board member on a number of TASE listed companies, including First ET View LTD, Priortech LTD, Aran R&D (1982) LTD, LeumiStart Fund and SDS LTD, Ms. Fain was the Business Development Manager at Giora Eiland Ltd., a representative of The Cheyne Capital Group in Israel, CEO of InterVision, Co-manager of the Aran Medical Ventures hedge fund, Marketing Manager at Datasphere Ltd. and an independent marketing consultant for TCB. She earned an Executive MBA and a BA in Humanities at Tel Aviv University and completed a one year course in Management at the Tel Aviv campus of the College of Management.

Oded Nagar joined our Board of Directors in March 2015. He currently serves as CEO and Owner of ABC – Advance Business Consulting Ltd, as the CEO of Galaxy Properties and Real Estate LTD and as a board member of Bunkersec Ltd. In addition to serving as a board member on a number of TASE listed companies, including IDB Development LTD, Gamatronic Electronic Industries LTD and Biri-Barashi Ltd., Mr. Nagar was the CEO and Founder of Pretium Group LTD/Pretium Renewable Energy LTD, VP Finance and Operations at Matrix IT (Formula Group) and the CFO of Bashan Systems (Formula Group). Previously, Oded worked in the Department of the General Controller at the Ministry of Finance in Israel, as an accountant at KPMG Israel and as an Economist at Bank Leumi. He earned an MBA in Finance and Banking and Information Systems and a BA in Accounting and Economics from the Hebrew University of Jerusalem. Mr. Nagar is also a Certified Public Accountant in Israel.



Dr. Jonathan Schapiro joined our Board of Directors in December 2014. He is currently an Adjunct Clinical Assistant Professor in the Department of Medicine, Division of Infectious Diseases and Geographic Medicine at Stanford University School of Medicine and a Director of HIV/AIDS at the National Hemophilia Center at Sheba Medical Center in Tel-Aviv, Israel. He has served as a committee member on the United States Food and Drug Administration Antiviral Drugs Advisory Committee and is a member of the World Health Organization Global HIV Drug Resistance Network Steering Group. Dr. Schapiro is on the organizing and scientific committee of international conferences on antiviral drug development, clinical pharmacology and resistance, as well as contributing to guidelines publications. His research has appeared in major journals such as Lancet and Annals of Internal Medicine. He has served on the scientific advisory boards of major pharmaceutical and molecular diagnostic companies and has been involved in the development of multiple antiviral drugs over the last 20 years. Dr. Schapiro has devoted his career to HIV clinical care, research and education since completing his Fellowship in Infectious Diseases and Geographic Medicine at Stanford University School of Medicine, Stanford CA. He graduated from the Ben Gurion University School of Medicine and completed his Medical Residency at the Rabin Medical Center in Israel.

Dr. Dobroslav Melamed joined our Board of Directors in December 2014. He is a biotech entrepreneur with over 10 years of experience in the life science industry. He has demonstrated success in taking drugs from the lab to the shelf by identifying target markets, planning regulatory strategy, raising capital, executing successful clinical trials and scaling up to commercial production. He is currently establishing two companies involved in the development of a treatment for Ebola and novel drug delivery. Until September 2014, he was the President of SciVac (formerly SciGen IL), a high growth biopharmaceutical company that develops, manufactures and markets recombinant human health care biotechnology derived products, including vaccines. Dr. Melamed was responsible for SciVac's operations, clinical trials and new business. Dr. Melamed is the co-founder of Periness LTD, a developer of new drugs for male infertility and Oshadi LTD, a developer of oral carriers for proteins like insulin. He has also been a researcher at Bar-Ilan University's Male Fertility clinic, where he assisted in the development of new drugs for male infertility; and QBI, where he worked in the Pre-clinical and Research Pharmacology Department establishing In-Vivo models for drug discovery and delivery. Dr. Melamed earned a PhD in Biotechnology and a Bachelor of Arts degree in Biotechnology from the Bar-Ilan University, Israel.

Doron Turgeman joined our Board of Directors in December 2014. He has significant public company experience with both NASDAQ and TASE listed companies. Mr. Turgeman is currently the Chief Executive Officer of B Communications (BCOM) and Internet Gold (IGLD), both of which are listed on the NASDAQ. He has gained considerable experience in mergers and acquisitions involving both debt and equity, with, among other things, the purchase of the controlling interest of Bezeq by B Communications. He is knowledgeable in capital markets in Israel, the US and Europe as well as SEC and TASE reporting standards. Throughout his career, he has proved to be a strong manager and has developed close relationships with key constituents throughout the industry. Mr. Turgeman holds a B.A. degree in Economics and Accounting from the Hebrew University of Jerusalem and is a certified public accountant in Israel.

Shlomo Shalev joined our Board of Directors in December 2014. He most recently served as Chairman of the Board of Micronet, a TASE listed company. In addition to serving as a board member on a number of NASDAQ and TASE listed companies, such as OphirOptronics, Arel Communications and PowerDsine, Mr. Shalev was the Senior Vice President of Investments for Ampal. He has also worked on a number of transactions in mergers and acquisitions and

initial public offerings. With an educational background in economics, Mr. Shalev was Israel's Consul for Economic Affairs and the Economic Advisor to the Director General, Ministry of Industry and Trade. Mr. Shalev holds an MBA from the University of San Francisco and a B.A. degree in Economics from the University of Ben Gurion, Beer Sheva, Israel.

Josh Levine was appointed Chief Executive Officer of XTL in October 2013. Mr. Levine was the Chief Executive Officer of Proteologics Ltd. (TASE: PRTL) from January 2011 until October 2013. Previously, from September 2008 until September 2010, he was Chairman of the Board of Proteologics Ltd. Concurrently, he was Senior Director at Teva Innovative Ventures responsible for, among other things, business development as well as alliance management for the unit. He had also held several executive positions within venture capital funds and boutique investment banks. Previously, he was a corporate attorney at a large New York City law firm. Mr. Levine holds a JD degree from Columbia University Law School and a BA degree in Chemistry from Yeshiva University.

David Kestenbaum was appointed Chief Financial Officer in our Company in January 2014. Before joining XTL, he served as CFO of Zenith Solar Ltd., a start-up company involved in the development and deployment of innovative solar energy technology from 2010 to 2012. Prior positions include Finance Director of Colbar Lifescience Ltd., a medical device/biotech company and division of Johnson and Johnson (NYSE:JNJ) from 2007 to 2010, CFO of ZAG Industries Ltd., a division of The Stanleyworks (NYSE:SWK) from 2003 to 2007, and CFO and other senior financial positions at affiliates of Unilever NV (NYSE: UN) in the US and Israel. He worked in public accounting at PriceWaterhouseCoopers in NY from 1986 to 1990. Mr. Kestenbaum is a US Certified Public Accountant and holds a BSc in Accounting from Yeshiva University (NY), and a MBA in Finance and International Business from Columbia University (NY).

Prof. Moshe Mittelman has served as the Medical Director at our company since August 2010. He is also a Hematology consultant and Director of the Department of Medicine at the Tel Aviv Sourasky (Ichilov) Medical Center, Israel. Since 1997, Moshe has been Clinical Associate Professor of Medicine at the Sackler School of Medicine, Tel Aviv University. A well-known hematologist focusing on cancer and erythropoietin (EPO) research, Prof. Mittelman was one of the first hematologists to apply rHuEPO in the clinical practice, which allowed him to make the pioneering observation of prolonged survival in Multiple Myeloma rHuEPO-treated patients. This led to extensive research both in the lab as well as with patients, showing previously unrecognized immune effects to EPO. This research project has resulted in a series of scientific papers published in prestigious journals. Prof. Mittelman is also a well-known speaker in international conferences. Prof. Mittelman's work led to the founding of Bio-Gal, Ltd. which has now merged with XTL. Prof. Mittelman has also served as President of the Israel Society of Internal Medicine, Secretary of the Israel Society of Hematology and a Hematology Consultant for the Israel Ministry of Health. Prof. Mittelman is also a consultant to various biotech companies. From 2008-2010, he served as a member of the national committee of the Health Basket in Israel. From 2007 until 2013, Prof. Mittelman served as a director of Gaon Holdings Ltd. (TASE: GAON), a public holding company.

## **Employment Agreements**

### ***Joshua Levine***

We have an agreement dated as of September 11, 2013, as amended on January 30, 2014, between the Company and Mr. Joshua Levine, our Chief Executive Officer ("CEO"). The agreement is in effect as of the date of approval at the Company's general meeting of shareholders on March 10, 2014, and will continue for a three-year term as of that date. Mr. Levine commenced his term as CEO on October 15, 2013 and is entitled to a monthly gross base salary of NIS 40,000 (NIS 480,000 annually), paid retroactively, effective from said commencement date. Either party may terminate the agreement upon three months' advance written notice during the first year of the agreement and 4 months' advance written notice thereafter.

Upon the successful completion of cash fund raising of at least US\$3 million in a public offering or private placement of equity securities, including securities convertible or exercisable into equity of the Company or any entity under its control (which for this purpose means ownership by the Company of greater than 50% of the outstanding voting securities), as long as Mr. Levine is appointed as such entity's CEO, during the thirty six month period from the date of the agreement, the Company will pay Mr. Levine a bonus equal to 1% of the above fund raising amount, up to a maximum aggregate amount of US\$200,000 in any calendar year. In the event the Company or any of its wholly-owned subsidiaries or any entity under its control, as long as Mr. Levine is appointed as such entity's CEO, receives payment in connection with any collaboration or other transaction relating to their respective products or technologies, excluding payments made to finance specific research and development activity and royalty payments, Mr. Levine shall be entitled to payment of 1% of the cash actually received by the Company in such transaction, up to an aggregate maximum amount of US\$200,000 in any calendar year. In the event the Company or any of its wholly-owned subsidiaries or any entity under its control, as long as Mr. Levine is appointed as such entity's CEO, receives payment in connection with payments made to finance specific research and development activity, Mr. Levine shall be entitled to receive payment of 0.5% of such funding actually received by the Company up to an aggregate maximum of US\$200,000 in any calendar year and per single research and development funding. The aggregate of all such bonuses paid to Mr. Levine in any calendar year cannot exceed US\$300,000.

In consideration for his service as the Company's CEO, Mr. Levine will be entitled to benefits such as convalescence pay, managers' insurance, a study fund and a Company vehicle. He will also be entitled to an allotment of 1,500,000 non-marketable stock options, without charge, exercisable into 1,500,000 ordinary shares of the Company, NIS 0.1 par value each, subject to the adjustments specified in the Company's option plan (the "Options"). Assuming that the full amount of options is exercised, the shares deriving from the said exercise will constitute 0.64% of the issued and paid up capital, and 0.58% on a fully diluted basis. It should be noted that Mr. Levine does not hold any securities of the Company. The exercise price of 600,000 of the Options is NIS 0.60 each, non-linked, reflecting a price higher than the average share price in the 30 days preceding the date of the Board of Directors' resolution. The exercise price of 900,000 of the Options is NIS 0.90 each. Mr. Levine will be entitled to receive the Options and exercise them within a maximum period of 120 months from the date of allotment, subject to the terms and conditions contained herein, and based on a maturity period of 36 months, such that 1/12 of the Options granted to him will mature at the end of each consecutive calendar quarter following the grant date. Following the lapse of 36 months, all the Options may be exercised by him, subject to Mr. Levine continuing to serve in his position as CEO during that period.

***David Kestenbaum***

We have an agreement dated as of January 9, 2014, effective as of January 5, 2014, between the Company and Mr. David Kestenbaum, our Chief Financial Officer (“CFO”). Mr. Kestenbaum is responsible for the financial and accounting management of the Company. The agreement shall remain in effect for a three-year term as of the effective date. Mr. Kestenbaum is entitled to a monthly gross base salary of NIS 33,000 (NIS 396,000 annually). The agreement may be terminated by either party without cause at any time upon 60 days’ prior written notice.

Upon the successful completion of fund raising of at least US\$ 3 million in a public offering or private placement of equity securities, including securities convertible or exercisable into equity by the Company within a period of three years as of the effective date and, as long as Mr. Kestenbaum is employed by the Company as CFO, Mr. Kestenbaum shall be granted with a one-time bonus payment equal to 0.6% of the funds raised, and up to maximum aggregate payment of US\$120,000 per year. Upon the successful completion of a transaction made by the Company or any of its fully owned subsidiaries or any entity in its control receives payment in connection with any collaboration or other transaction relating to their respective products or technologies, excluding payments made to finance specific research and development activity and royalty payment, as long as the Mr. Kestenbaum is employed by the Company as CFO, Mr. Kestenbaum shall be granted with a one-time payment equal to 0.5% of the transaction amount actually received by the Company in such Transaction, whether as upfront payments, milestone payments or payments of any other form, and up to maximum aggregate payment of US\$100,000 per year. Upon the successful completion of a research and development funding in the Company, Mr. Kestenbaum shall be granted a one-time bonus payment equal to 0.4% of the funding amount, and up to a maximum aggregate payment of US\$75,000 per year. The aggregate of all such bonuses paid to Mr. Kestenbaum in any calendar year cannot exceed US\$150,000.

Mr. Kestenbaum is entitled to pension and severance benefits, managers’ insurance as commonly acceptable for office holders and use of a Company car. There is a non-compete clause surviving one year after the termination for any reason of his employment. Mr. Kestenbaum shall be issued 750,000 options to purchase 750,000 ordinary shares of the Company of nominal value of NIS 0.1 each, available through the Company’s ESOP, at an exercise price of NIS 0.5328 per share. The Options shall vest and become exercisable on a quarterly basis, over a period of 36 months thereafter for as long as Mr. Kestenbaum’s employment with the Company has not terminated.

***Moshe Mittelman***

We have an agreement dated July 12, 2010, and effective as of August 27, 2010, with Prof. Moshe Mittelman, our Medical Director. Prof. Mittelman is entitled to a monthly fee of \$2,500. His entitlement began 90 days after the date of completion of the Bio-Gal transaction, i.e., November 3, 2010. The agreement is limited to the date of successful completion of the phase 2 clinical trial of rHuEPO. A “successful completion of the phase 2 clinical trial” is defined as: six (6) months after the trial of rHuEPO on the last patient in accordance with trial protocol, or on an earlier date if XTL notifies Yeda of XTL’s desire to discontinue the trial. In August 2010, our Board of Directors approved the

agreement as well as the grant of options to Prof. Mittelman to purchase a total of 640,000 ordinary shares at an exercise price of NIS 0.1 per share. These options were vested over a twenty four-month period, on a monthly basis, commencing from August 27, 2010.

### **C. Compensation**

The aggregate compensation paid by us to all persons who served as directors or officers for the year 2014 (11 persons, including the former CEO and CFO) was approximately \$ 0.6 million. This amount includes payments of approximately \$0.1 million made for social security, pension, disability insurance and health insurance premiums, severance accruals, payments made in lieu of statutory severance, payments for continuing education plans, payments made for the redemption of accrued vacation, and amounts expended by us for automobiles made available to our officers.

All members of our Board of Directors who are not our employees are reimbursed for their expenses for each meeting attended, save for Mr. David Bassa, who is a significant shareholder of our Company. Our directors are eligible to receive share options under our share option plans. Non-executive directors do not receive any remuneration from us other than fees for their services as members of the board or committees of the board and expense reimbursement, save for one director who is eligible for fees for consulting services provided to the Company.

In December 2014, pursuant to a shareholders' meeting, we granted to four of our directors – Mr. Doron Turgeman, Mr. Shlomo Shalev, Dr. Jonathan Schapiro and Dr. Dobroslav Melamed – 150,000 options each to purchase our ordinary shares of NIS 0.1 par value, exercisable at an exercise price of NIS 0.4325 (which is the average of the thirty-day closing price on TASE prior to the Board resolution in the matter). 33% of the options shall vest and be exercisable at the lapse of one year from the grant date, and the remaining 67% shall vest and be exercisable on a quarterly basis, commencing from the grant date, for the duration of two years.

In March 2012, we granted to our external directors, Mr. Diamant Jaron and Ms. Dafna Cohen, 150,000 options each to purchase our ordinary shares of NIS 0.1 par value, pursuant to the shareholder meeting of March 19, 2012, exercisable at an exercise price of NIS 0.58633 (which is the average of the three-day closing price on TASE prior to the issuance). 33% of the options are vested and the remaining 67% shall vest and be exercisable on a monthly basis, commencing from the date of the mentioned shareholders meeting, for the duration of two years. The directorships of Ms. Cohen and Mr. Diamant lapsed on March 18, 2015, so that they may exercise the 300,000 vested options granted to them until March 17, 2016.

In March 2015, pursuant to a shareholders' meeting, the monetary compensation was set for non-executive directors as follows: annual consideration of \$10,000 (to be paid in 4 equal quarterly payments), payments of \$375 for attendance at each board or committee meeting in person, \$190 for meetings held by teleconference, \$160 for unanimous board resolutions and reimbursement of reasonable out-of-pocket expenses.

We granted to three of our former directors, Mr. Yonay, Mr. Shweiger and Mr. Allouche, 150,000 options each, to purchase our ordinary shares of NIS 0.1 par value, pursuant to the shareholder meeting of March 2, 2010, exercisable at an exercise price of NIS 0.298 (which is the average of the three-day closing price on TASE prior to the issuance). 33% of the options are vested and the remaining 67% shall vest and be exercisable on a monthly basis, commencing from March 2, 2010, for the duration of two years. On November 22, 2010, Mr. Shweiger ceased his directorship in the Company and therefore 63,747 of the total options granted to him were forfeited. Upon his departure, Mr. Shweiger exercised the vested 86,253 options. Mr. Allouche ceased his directorship in the Company on May 18, 2014, and during August 2014 he exercised the 150,000 vested options granted to him. Mr. Yonay's directorship lapsed on December 30, 2014 and may exercise the 150,000 vested options granted to him until December 29, 2015.

For further details regarding share options granted to our employees, directors and service providers, see Note 20 to the consolidated financial statements for the year ended December 31, 2014.

In accordance with the requirements of Israeli Law, we determine our directors' compensation in the following manner:



first, our compensation committee reviews the proposal for compensation.

second, provided that the compensation committee approves the proposed compensation, the proposal is then submitted to our Board of Directors for review, except that a director who is the beneficiary of the proposed compensation does not participate in any discussion or voting with respect to such proposal; and

finally, if our Board of Directors approves the proposal, it must then submit its recommendation to our shareholders, which is usually done in connection with our shareholders' general meeting.

The approval of a majority of the shareholders voting at a duly convened shareholders meeting is required to implement any such compensation proposal.

**D.**

**Board practices**

*Election of Directors and Terms of Office*

Our Board of Directors currently consists of seven members, including our non-executive Chairman. Other than our two external directors, our directors are elected by an ordinary resolution at the annual general meeting of our shareholders. The nomination of our directors is proposed by a nomination committee of our Board of Directors, whose proposal is then approved by the board. The current members of the nomination committee are Mr. David Bassa (chairman of the Board of Directors), Mrs. Osnat Hillel Fain and Mr. Oded Nagar. Our board, following receipt of a proposal of the nomination committee, has the authority to add additional directors up to the maximum number of 12 directors allowed under our Articles. Such directors appointed by the board serve until the next annual general meeting of the shareholders. Unless they resign before the end of their term or are removed in accordance with our Articles, all of our directors, other than our external directors, will serve as directors until our next annual general meeting of shareholders. In July 2011, at an annual general meeting of our shareholders, Amit Yonay, Marc Allouche, and David Grossman were re-elected to serve as directors of our company. Dafna Cohen and Jaron Diament were elected to serve as external directors of our company at the March 2009 extraordinary general meeting. Dafna Cohen and Jaron Diament are serving as external directors pursuant to the provisions of the Israeli Companies Law for a three-year term ending in March 2012. On March 19, 2012 at an annual general meeting of our shareholders, Amit Yonay, Marc Allouche and David Grossman were re-elected to serve as directors of our company until the next shareholders meeting and our external directors, Dafna Cohen and Jaron Diament, were re-elected to serve as external directors of our company for an additional period of three years. After this date, the external directors term of service may be renewed for an additional three-year term. On November 7, 2013, David Grossman resigned from his position as a director and Mr. David Bassa was appointed in his stead. On May 18, 2014, Mr. Marc Allouche resigned from his position as a director. On December 30, 2014, the annual general meeting of our shareholders appointed four new members to the Company's board of directors – Dr. Jonathan Schapiro, Dr. Dobroslav Melamed, Mr. Doron Turgeman and Mr. Shlomo Shalev. Mr. Amit Yonay was not nominated for re-appointment at the same annual general meeting of our shareholders and his term as director lapsed as of the same date. At the same annual general meeting, Mr. David Bassa was re-elected to serve as a director of the Company.

None of our directors or officers has any family relationship with any other director or officer.

Our Articles permit us to maintain directors' and officers' liability insurance and to indemnify our directors and officers for actions performed on behalf of us, subject to specified limitations. We maintain a directors and officers insurance policy which covers the liability of our directors and officers as allowed under Israeli Companies Law.

There are no service contracts or similar arrangements with any director that provide for benefits upon termination of a directorship.

***External and Independent Directors***

The Israeli Companies Law requires Israeli companies with shares that have been offered to the public either in or outside of Israel to appoint two external directors. No person may be appointed as an external director if that person or that person's relative, partner, employer or any entity under the person's control, has or had, on or within the two years preceding the date of that person's appointment to serve as an external director, any affiliation with the company or any entity controlling, controlled by or under common control with the company. The term affiliation includes:

· an employment relationship;

· a business or professional relationship maintained on a regular basis;

· control; and

· service as an office holder, other than service as an officer for a period of not more than three months, during which the company first offered shares to the public.

No person may serve as an external director if that person's position or business activities create, or may create, a conflict of interest with that person's responsibilities as an external director or may otherwise interfere with his/her ability to serve as an external director. If, at the time external directors are to be appointed, all current members of the Board of Directors are of the same gender, then at least one external director must be of the other gender. A director in one company shall not be appointed as an external director in another company if at that time a director of the other company serves as an external director in the first company. In addition, no person may be appointed as an external director if he/she is a member or employee of the Israeli Security Authority, and also not if he/she is a member of the Board of Directors or an employee of a stock exchange in Israel.

External directors are to be elected by a majority vote at a shareholders' meeting, provided that either:

the majority of shares voted at the meeting, including at least one-half of the shares held by non-controlling shareholders or other shareholders who have a personal interest in such election voted at the meeting, vote in favor of election of the director, with abstaining votes not being counted in this vote; or

the total number of shares held by non-controlling shareholders voted against the election of the director does not exceed two percent of the aggregate voting rights in the company.

The initial term of an external director is three years and may be extended for two additional three-year terms. An external director may be removed only by the same percentage of shareholders as is required for their election, or by a court, and then only if such external director ceases to meet the statutory qualifications for their appointment or violates his or her duty of loyalty to the company. Both external directors must serve on every committee that is empowered to exercise one of the functions of the Board of Directors.

An external director is entitled to compensation as provided in regulations adopted under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with service provided as an external director.

Osnat Hillel Fain and Oded Nagar serve as external directors pursuant to the provisions of the Israeli Companies Law. They both serve on our audit committee, our committee for the approval of financial statements, our nomination committee and our compensation committee.

#### *Audit Committee*

The Israeli Companies Law requires public companies to appoint an audit committee. The responsibilities of the audit committee include identifying irregularities in the management of the company's business and approving related party transactions as required by law. An audit committee must consist of at least three directors, including all of its external directors. The chairman of the Board of Directors, any director employed by or otherwise providing services to the company, and a controlling shareholder or any relative of a controlling shareholder, may not serve as members of the audit committee. An audit committee may not approve an action or a transaction with a controlling shareholder, or with an office holder, unless at the time of approval two external directors are serving as members of the audit committee and at least one of the external directors was present at the meeting in which an approval was granted.

Our audit committee is currently comprised of three independent non-executive directors. The audit committee is chaired by Doron Turgeman, who serves as the audit committee financial expert, with Osnat Hillel Fain and Oded Nagar as members. The audit committee meets at least four times a year and monitors the adequacy of our internal controls, accounting policies and financial reporting. It regularly reviews the results of the ongoing risk self-assessment process, which we undertake, and our interim and annual reports prior to their submission for approval by the full Board of Directors. The audit committee oversees the activities of the internal auditor, sets its annual tasks and goals and reviews its reports. The audit committee reviews the objectivity and independence of the external auditors and also considers the scope of their work and fees.

We have adopted a written charter for our audit committee, setting forth its responsibilities as outlined by the regulations of the SEC. In addition, our audit committee has adopted procedures for the receipt, retention and treatment of complaints we may receive regarding accounting, internal accounting controls, or auditing matters and the submission by our employees of concerns regarding questionable accounting or auditing matters. In addition, SEC rules mandate that the audit committee of a listed issuer consist of at least three members, all of whom must be independent, as such term is defined by rules and regulations promulgated by the SEC. We are in compliance with the independence requirements of the SEC rules.

***Financial Statement Examination Committee***

The Israeli Companies Law regulations require each public company to appoint a committee that examines the financial statements (the “Committee”) which shall be compounded from at least three (3) members, of which the majority among them shall be independent directors and the Committee’s Chairman shall be an external director. The Committee’s duties are, among other things, to examine the Company’s financial statements and to recommend and report to the board of directors of the Company regarding any problem or defect found in such financial statements.

In addition to the above-said, all of the Committee’s members must meet the following requirements:

All members shall be members of the board of directors of the Company.

At least one of the Committee’s members shall have financial and accounting expertise and the rest of the Committee’s members must have the ability to read and understand financial statements.

The Company is in full compliance with the requirements outlined above.

According to a resolution of our Board of Directors, the Audit Committee has been assigned the responsibilities and duties of a financial statements examination committee, as permitted under relevant regulations promulgated under the Companies Law. From time to time as necessary and required to approve our financial statements, the Audit Committee holds separate meetings, prior to the scheduled meetings of the entire Board of Directors, regarding financial statement approval. The function of a financial statements examination committee is to discuss and provide recommendations to its board of directors (including the report of any deficiency found) with respect to the following issues: (i) estimations and assessments made in connection with the preparation of financial statements; (ii) internal controls related to the financial statements; (iii) completeness and propriety of the disclosure in the financial statements; (iv) the accounting policies adopted and the accounting treatments implemented in material matters of the Company; (v) value evaluations, including the assumptions and assessments on which evaluations are based and the supporting data in the financial statements. Our independent auditors and our internal auditors are invited to attend all meetings of the Audit Committee when it is acting in the role of the financial statements examination committee.

***Compensation Committee***

Amendment no. 20 to the Companies Law was published on November 12, 2012 and became effective on December 12, 2012 (“Amendment no. 20”). In general, Amendment no. 20 requires public companies to appoint a compensation committee and to adopt a compensation policy with respect to its officers (the “Compensation Policy”). In addition, Amendment no. 20 addresses the corporate approval process required for a public company’s engagement with its officers (with specific reference to a director, a non-director officer, a chief executive officer and controlling shareholders and their relatives who are employed by the company).

The compensation committee shall be nominated by the board of directors and be comprised of its members. The compensation committee must consist of at least three members. All of the external directors must serve on the compensation committee and constitute a majority of its members. The remaining members of the compensation committee must be directors who qualify to serve as members of the audit committee (including the fact that they are independent) and their compensation should be identical to the compensation paid to the external directors of the company. The approval of the compensation committee is required in order to approve terms of office and/or employment of office holders. The Company’s Compensation Policy was duly approved on November 19, 2013.

Similar to the rules that apply to the audit committee, the compensation committee may not include the chairman of the board, or any director employed by the company, by a controlling shareholder or by any entity controlled by a controlling shareholder, or any director providing services to the company, to a controlling shareholder or to any entity controlled by a controlling shareholder on a regular basis, or any director whose primary income is dependent on a controlling shareholder, and may not include a controlling shareholder or any of its relatives. Individuals who are not permitted to be compensation committee members may not participate in the committee’s meetings other than to present a particular issue; provided, however, that an employee that is not a controlling shareholder or relative may participate in the committee’s discussions, but not in any vote, and the company’s legal counsel and corporate secretary may participate in the committee’s discussions and votes if requested by the committee.

The roles of the compensation committee are, among other things, to: (i) recommend to the board of directors the Compensation Policy for office holders and recommend to the board once every three years the extension of a Compensation Policy that had been approved for a period of more than three years; (ii) recommend to the directors any update of the Compensation Policy, from time to time, and examine its implementation; (iii) decide whether to approve the terms of office and of employment of office holders that require approval of the compensation committee; and (iv) decide, in certain circumstances, whether to exempt the approval of terms of office of a chief executive officer from the requirement of shareholder approval.

The Compensation Policy requires the approval of the general meeting of shareholders with a “Special Majority”, which requires a majority of the shareholders of the company who are not either a controlling shareholder or an “interested party” in the proposed resolution, or the shareholders holding less than 2% of the voting power in the company voted against the proposed resolution at such meeting. However, under special circumstances, the board of directors may approve the Compensation Policy without shareholder approval, if the compensation committee and thereafter the board of directors decided, based on substantiated reasons after they have reviewed the compensation policy again, that the Compensation Policy is in the best interest of the company.

Amendment no. 20 details the considerations that should be taken into account in determining the Compensation Policy and certain issues which the Compensation Policy should include.

Mr. Shlomo Shalev is the chairman of our compensation committee. Mrs. Osnat Hillel Fain and Mr. Oded Nagar serve as the other members of our compensation committee.

#### *Approval of Compensation to Our Officers*

The Israeli Companies Law prescribes that compensation to officers must be approved by a company’s board of directors.

As detailed above, our compensation committee consists of three independent directors: Mr. Shlomo Shalev, Mrs. Osnat Hillel Fain and Mr. Oded Nagar. The responsibilities of the compensation committee are to set our overall policy on executive remuneration and to decide the specific remuneration, benefits and terms of employment for directors, officers and the Chief Executive Officer.

The objectives of the compensation committee’s policies are that such individuals should receive compensation which is appropriate given their performance, level of responsibility and experience. Compensation packages should also allow us to attract and retain executives of the necessary caliber while, at the same time, motivating them to achieve the highest level of corporate performance in line with the best interests of shareholders. In order to determine the elements and level of remuneration appropriate to each executive director, the compensation committee reviews surveys on executive pay, obtains external professional advice and considers individual performance.

#### *Internal Auditor*



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Under the Israeli Companies Law, the board of directors must appoint an internal auditor, nominated by the audit committee. The role of the internal auditor is to examine, among other matters, whether the company's actions comply with the law and orderly business procedure. Under the Israeli Companies Law, 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 or director of the company; or
  
- a member of the company's independent accounting firm.

We comply with the requirement of the Israeli Companies Law relating to internal auditors. Our internal auditors examine whether our various activities comply with the law and orderly business procedure.

**E.**

**Employees**

As of the date hereof, the Company has three full-time employees, and two part-time service providers (one of whom is an officer). We and our Israeli employees are subject, by an extension order of the Israeli Ministry of Welfare, to certain provisions of collective bargaining agreements between the Histadrut, the General Federation of Labor Unions in Israel and the Coordination Bureau of Economic Organizations, including the Industrialists Associations. These provisions principally address cost of living increases, recreation pay, travel expenses, vacation pay and other conditions of employment. We provide our employees with benefits and working conditions equal to or above the required minimum. Other than those provisions, our employees are not represented by a labor union.

## F. Share Ownership

The following table sets forth certain information as of April 26, 2015, regarding the beneficial ownership of our directors and executive officers.

	Amount and nature of beneficial ownership					
	Ordinary shares beneficially owned excluding options	<b>Options<sup>1</sup> exercisable within 60 days of April 26, 2015</b>	Total ordinary shares beneficially owned including options	Percent of ordinary shares beneficially owned		
David Bassa <i>Chairman of the Board</i>	23,128,227	—	23,128,227	8.46	%	
Osnat Hillel Fain <i>External Director</i>	—	—	—	*		
Oded Nagar <i>External Director</i>	—	—	—	*		
Dr. Jonathan Schapiro <i>Director</i>	—	—	—	*		
Dr. Dobroslav Melamed <i>Director</i>	—	—	—	*		
Doron Turgeman <i>Director</i>	570,000	—	570,000	*		
Shlomo Shalev <i>Director</i>	—	—	—	*		
Josh Levine <i>Chief Executive Officer</i>	—	804,167	2 804,167	*		
David Kestenbaum <i>Chief Financial Officer</i>	—	366,667	3 366,667	*		
Prof. Moshe Mittelman <i>Medical Director</i>	5,562,715	640,000	4 6,202,715	2.03	%	
All directors and executive officers as a group (10 persons)	29,260,942	1,810,834	30,071,776	10.70	%	

(1) Options to purchase ordinary shares

300,000 options at an exercise price of NIS 0.6 per ordinary share of NIS 0.1 par value, 450,000 options at an exercise price of NIS 0.9 per ordinary share of NIS 0.1 par value, all exercisable until January 29, 2024 and 54,167 options at an exercise price of NIS 0.4 per ordinary share of NIS 0.1 par value, all exercisable until March 24, 2025.

(2) 312,500 options at an exercise price of NIS 0.5328 per ordinary share of NIS 0.1 par value, exercisable until December 29, 2023 and 54,167 options at an exercise price of NIS 0.4 per ordinary share of NIS 0.1 par value, all

exercisable until March 24, 2025.

(4) 640,000 options at an exercise price of NIS 0.1 per ordinary share of NIS 0.1 par value, exercisable until August 26, 2020.

\*

Represents less than 1% of ordinary shares outstanding.

### *Share Option Plans*

We maintain the following share option plans for our and our subsidiary's employees, directors and consultants. In addition to the discussion below, see Note 20 of our consolidated financial statements for the year ended December 31, 2014.

Our Board of Directors administers our share option plans and has the authority to designate all terms of the options granted under our plans including the grantees, exercise prices, grant dates, vesting schedules and expiration dates, which may be no more than ten years after the grant date. Options may not be granted with an exercise price of less than the fair market value of our ordinary shares on the date of grant, unless otherwise determined by our Board of Directors.

As of December 31, 2014, we have granted to employees, directors and consultants options that are outstanding to purchase up to 6,683,862 ordinary shares of NIS 0.1 par value, pursuant to two share option plans and pursuant to certain grants apart from these plans also discussed below under Non-Plan Share Options.

#### *2001 Share Option Plan*

Under a share option plan established in 2001, referred to as the 2001 Plan, we granted options during 2001-2011, at an exercise price between \$0.03 and \$1.58 per ordinary share of NIS 0.1 par value. Up to 2,200,000 options of NIS 0.1 par value were available to be granted under the 2001 Plan. On July 29, 2009, the option pool was increased by 5,000,000 unissued additional ordinary shares of NIS 0.1 par value, as well as forfeited and expired options that reverted to the pool due to departure of employees. As of December 31, 2014, 850,000 options were outstanding. Options granted to Israeli employees were in accordance with section 102 of the Tax Ordinance, under the capital gains option set out in section 102(b)(2) of the ordinance. The options are non-transferable.

The option term is for a period of ten years from the grant date. The options were granted for no consideration. The options vest over a three or two year period. As of December 31, 2014, 850,000 options were fully vested. On May 2, 2011, the 2001 Share Option Plan expired and no options may be granted under this plan.

#### *2011 Share Option Plan*

On August 29, 2011, the Company's Board of Directors approved the adoption of an employee stock option scheme for the grant of options exercisable into shares of the Company according to section 102 to the Israeli Tax Ordinance ("**2011 Plan**"), and to maintain up to 10 million shares in the framework of the 2011 Plan, for options allocation to employees, directors and Company consultants.

The 2011 Plan shall be subject to section 102 of the Israeli Tax Ordinance. According to the Capital Gain Track, which was adopted by the Company and the abovementioned section 102, the Company is not entitled to receive a tax deduction that relates to remuneration paid to its employees, including amounts recorded as salary benefit in the Company's accounts for options granted to employees in the framework of the 2011 Plan, except the yield benefit component, if available, that was determined on the grant date. The terms of the options which will be granted according to the 2011 Plan, including option period, exercise price, vesting period and exercise period, shall be determined by the Company's Board of Directors on the date of the actual allocation. As of December 31, 2014, we have granted 5,713,862 share options under the 2011 Plan at an exercise price between \$0.12 and \$0.37 per ordinary share of NIS 0.1 par value.

*Non-Plan Share Options*

In addition to the options granted under our share option plans, there are 120,000 of NIS 0.1 par value outstanding options as of December 31, 2014, which were granted to consultants and a member of our Scientific Advisory Board, not under an option plan during 2011. The options were granted at an exercise price of \$0.16. As of December 31, 2014, 120,000 options of NIS 0.1 par value were fully vested.

For further details regarding share options granted to our employees, directors and service providers, see Note 20 to the consolidated financial statements for the year ended December 31, 2014.

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS****A. Major shareholders**

As of the date hereof, there were 4,481,203 ADSs outstanding, held by 47 DTC participants and 2 registered shareholders, whose holdings represented approximately 32.77% of the total outstanding ordinary shares.

The following table sets forth the number of our ordinary shares owned by any person known to us to be the beneficial owner of 5% or more of our ordinary shares as of the date hereof. The information in this table is based on 273,525,799 outstanding ordinary shares as of such date. The number of Ordinary Shares beneficially owned by a person includes Ordinary Shares subject to options held by that person that were currently exercisable. None of the holders of the Ordinary Shares listed in this table have voting rights different from other holders of the Ordinary Shares.

Name	Number of shares owned	Percent of ordinary shares	
Alexander Rabinovitch	47,453,776	17.35	%
Sabby Management, LLC	26,666,640	9.75	%
David Bassa	23,128,227	8.46	%

**B. Related Party Transactions**

To our knowledge, there are no related party transactions existing as of April 26, 2015.



## **Item 8. Financial Information**

### **Consolidated Statements and Other Financial Information**

Our audited consolidated financial statements appear in this annual report on Form 20-F. See “Item 18. Financial Statements.”

### **Legal Proceedings**

Neither we nor our subsidiaries are a party to, and our property is not the subject of, any material pending legal proceedings.

### **Dividend Distributions**

We have never declared or paid any cash dividends on our ordinary shares and do not anticipate paying any such cash dividends in the foreseeable future. Any future determination to pay dividends will be at the discretion of our Board of Directors. Cash dividends may be paid by an Israeli company only out of retained earnings as calculated under Israeli law. We currently have no retained earnings and do not expect to have any retained earnings in the foreseeable future.

### **Significant Changes**

On February 21, 2013 and after the reporting date, the Company’s special general meeting of shareholders and the general meeting of holders of warrants (series 2) of the Company decided to extend the exercise period of said warrants from February 27, 2013 to December 31, 2013. This decision is subject to the approval of the District Court pursuant to Section 350 to the Israeli Companies Law, 1999. On March 12, 2013 the Court approved the decision to extend the exercise price of the warrants. On January 14, 2014, the general meeting of shareholders and the general meeting of holders of warrants (series 2) of the Company resolved to approve the extension of the term of warrants (series 2) of the Company until October 28, 2014, in accordance with the request for a settlement filed with and granted by the Tel-Aviv-Jaffa district court. On October 28, 2014, the outstanding 12,217,106 warrants (series 2) expired.



**ITEM 9. THE OFFER AND LISTING****Markets and Share Price History**

On June 1, 2012, the Company filed an application for relisting its ADSs on the Nasdaq Stock Exchange. On July 10, 2013, the Company received a notice from Nasdaq stating that the admission committee had approved the Company's application to relist its ADSs for trading on the Nasdaq Capital Market. Accordingly, on July 15, 2013, the Company's ADSs began trading on Nasdaq under the ticker symbol "XTLB".

**American Depositary Shares**

The following table presents, for the periods indicated, the high and low market closing prices for our ADSs as reported on the Nasdaq Stock Market from September 1, 2005 until April 16, 2009, on the Pink Sheets from April 17, 2009 until July 14, 2013, and on Nasdaq from July 15, 2013 to the present. For convenience of the readers of this report, the data below was adjusted so that all the quotes of our ADSs price would represent the current ADS-NIS 0.1 par value ordinary share ratio, meaning 1:20.

	US Dollar	
	High	Low
Last Six Calendar Months		
April 2015 (until April 26, 2015)	2.44	2.19
March 2015	2.57	2.03
February 2015	2.60	2.02
January 2015	2.19	1.88
December 2014	2.70	1.98
November 2014	2.58	1.85
October 2014	3.38	1.59
September 2014	2.25	1.70
Financial Quarters During the Past Two Full Fiscal Years		
Second Quarter of 2015 (until April 26, 2015)	2.44	2.19
First Quarter of 2015	2.60	1.88
Fourth Quarter of 2014	3.38	1.59
Third Quarter of 2014	3.50	1.70
Second Quarter of 2014	4.95	2.48
First Quarter of 2014	4.30	2.73
Fourth Quarter of 2013	5.49	2.24
Third Quarter of 2013	7.00	5.28
Second Quarter of 2013	6.35	4.95

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Full Five Financial Years

2014	4.95	1.59
2013	7.42	2.24
2012	8.50	3.00
2011	5.40	2.00
2010	4.70	0.55

The following table sets forth, for the periods indicated, the high and low closing prices of the NIS 0.1 par value ordinary shares (after the 1:5 share consolidation which was resolved on June 22, 2009) on the Tel-Aviv Stock Exchange. For comparative purposes only, we have also provided such figures translated into US Dollars at an exchange rate of 3.924 New Israeli Shekel per US Dollar, as of April 26, 2015 according to the Bank of Israel.

	New Israeli Shekel		US Dollar	
	High	Low	High	Low
Last Six Calendar Months				
April 2015 (until April 26, 2015)	0.470	0.446	0.120	0.114
March 2015	0.484	0.441	0.123	0.112
February 2015	0.479	0.395	0.122	0.101
January 2015	0.421	0.369	0.107	0.094
December 2014	0.495	0.382	0.126	0.097
November 2014	0.472	0.317	0.120	0.081
October 2014	0.523	0.315	0.133	0.080
Financial Quarters During the Past Two Full Fiscal Years				
Second Quarter of 2015 (until April 26, 2015)	0.470	0.446	0.120	0.114
First Quarter of 2015	0.484	0.369	0.123	0.094
Fourth Quarter of 2014	0.523	0.315	0.133	0.080
Third Quarter of 2014	0.580	0.338	0.148	0.086
Second Quarter of 2014	0.750	0.473	0.191	0.121
First Quarter of 2014	0.733	0.469	0.187	0.120
Fourth Quarter of 2013	0.974	0.383	0.248	0.098
Third Quarter of 2013	1.259	0.978	0.321	0.249
Second Quarter of 2013	1.143	0.905	0.291	0.231
First Quarter of 2013	1.348	1.079	0.344	0.275
Full Five Financial Years				
2014	0.750	0.315	0.191	0.080
2013	1.348	0.383	0.344	0.098
2012	1.675	0.521	0.427	0.133
2011	0.950	0.414	0.242	0.106
2010	0.681	0.193	0.174	0.049

<sup>2</sup> On June 22, 2009 a 1:5 share consolidation was resolved. All figures prior to the effective date were adjusted accordingly.

## **ITEM 10. ADDITIONAL INFORMATION**

### **Memorandum and Articles of Association**

#### *Objects and Purposes of the Company*

Pursuant to Part B, Section 3 of our Articles of Association, we may undertake any lawful activity.

#### *Powers and Obligations of the Directors*

Pursuant to the Israeli Companies Law and our Articles of Association, a director is not permitted to vote on a proposal, arrangement or contract in which he or she has a personal interest. Also, the directors may not vote on compensation to themselves or any members of their body, as that term is defined under Israeli law, without the approval of our audit committee and our shareholders at a general meeting. The power of our directors to enter into borrowing arrangements on our behalf is limited to the same extent as any other transaction by us.

The Israeli Companies Law codifies the fiduciary duties that office holders, including directors and executive officers, owe to a company. An office holder's fiduciary duties consist of a duty of care and a duty of loyalty. The duty of care generally requires an office holder to act with the same level of care as a reasonable office holder in the same position would employ under the same circumstances. The duty of loyalty includes avoiding any conflict of interest between the office holder's position in the company and such person's personal affairs, avoiding any competition with the company, avoiding exploiting any corporate opportunity of the company in order to receive personal advantage for such person or others, and revealing to the company any information or documents relating to the company's affairs which the office holder has received due to his or her position as an office holder.

#### *Indemnification of Directors and Officers; Limitations on Liability*

Israeli law permits a company to insure an office holder in respect of liabilities incurred by him or her as a result of an act or omission in the capacity of an office holder for:

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- a breach of the office holder's duty of care to the company or to another person;

a breach of the office holder's fiduciary duty to the company, provided that he or she acted in good faith and had reasonable cause to believe that the act would not prejudice the company; and

- a financial liability imposed upon the office holder in favor of another person.

Moreover, a company can indemnify an office holder for any of the following obligations or expenses incurred in connection with the acts or omissions of such person in his or her capacity as an office holder:

monetary liability imposed upon him or her in favor of a third party by a judgment, including a settlement or an arbitral award confirmed by the court; and

reasonable litigation expenses, including attorneys' fees, actually incurred by the office holder or imposed upon him or her by a court, in a proceeding brought against him or her by or on behalf of the company or by a third party, or in a criminal action in which he or she was acquitted, or in a criminal action which does not require criminal intent in which he or she was convicted; furthermore, a company can, with a limited exception, exculpate an office holder in advance, in whole or in part, from liability for damages sustained by a breach of duty of care to the company.

Our Articles of Association allow for insurance, exculpation and indemnification of office holders to the fullest extent permitted by law. We have entered into indemnification, insurance and exculpation agreements with our directors and executive officers, following shareholder approval of these agreements. We have directors' and officers' liability insurance covering our officers and directors for a claim imposed upon them as a result of an action carried out while serving as an officer or director, for (a) the breach of duty of care towards us or towards another person, (b) the breach of fiduciary duty towards us, provided that the officer or director acted in good faith and had reasonable grounds to assume that the action would not harm our interests, and (c) a monetary liability imposed upon him in favor of a third party.

***Approval of Related Party Transactions under the Israeli Companies Law***

*Fiduciary duties of the office holders*

The Israeli Companies Law imposes a duty of care and a duty of loyalty on all office holders of a company. The duty of care of an office holder is based on the duty of care set forth in connection with the tort of negligence under the Israeli Torts Ordinance (New Version) 5728-1968. This duty of care requires an office holder to act with the degree of proficiency with which a reasonable office holder in the same position would have acted under the same circumstances. The duty of care includes a duty to use reasonable means, in light of the circumstances, to obtain:

information on the advisability of a given action brought for his or her approval or performed by virtue of his or her position; and

All other important information pertaining to these actions.

The duty of loyalty requires an office holder to act in good faith and for the benefit of the company, and includes the duty to:

refrain from any act involving a conflict of interest between the performance of his or her duties in the company and his or her other duties or personal affairs;

refrain from any activity that is competitive with the business of the company;

refrain from exploiting any business opportunity of the company for the purpose of gaining a personal advantage for himself or herself or others; and



disclose to the company any information or documents relating to the company's affairs which the office holder received as a result of his or her position as an office holder.

We may approve an act performed in breach of the duty of loyalty of an office holder provided that the office holder acted in good faith, the act or its approval does not harm the company, and the office holder discloses his or her personal interest, as described below.

*Disclosure of personal interests of an office holder and approval of acts and transactions*

The Israeli Companies Law requires that an office holder promptly disclose to the company any personal interest that he or she may have and all related material information or documents relating to any existing or proposed transaction by the company. An interested office holder's disclosure must be made promptly and in any event no later than the first meeting of the board of directors at which the transaction is considered. An office holder is not obligated to disclose such information if the personal interest of the office holder derives solely from the personal interest of his or her relative in a transaction that is not considered as an extraordinary transaction.

The term personal interest is defined under the Israeli Companies Law to include the personal interest of a person in an action or in the business of a company, including the personal interest of such person's relative or the interest of any corporation in which the person is an interested party, but excluding a personal interest stemming solely from the fact of holding shares in the company. A personal interest furthermore includes the personal interest of a person for whom the office holder holds a voting proxy or the interest of the office holder with respect to his or her vote on behalf of the shareholder for whom he or she holds a proxy even if such shareholder itself has no personal interest in the approval of the matter. An office holder is not, however, obligated to disclose a personal interest if it derives solely from the personal interest of his or her relative in a transaction that is not considered an extraordinary transaction.

Under the Israeli Companies Law, an extraordinary transaction which requires approval is defined any of the following:

- a transaction other than in the ordinary course of business;
- a transaction that is not on market terms; or
- a transaction that may have a material impact on the company's profitability, assets or liabilities.

Under the Israeli Companies Law, once an office holder has complied with the disclosure requirement described above, a company may approve a transaction between the company and the office holder or a third party in which the office holder has a personal interest, or approve an action by the office holder that would otherwise be deemed a breach of duty of loyalty. However, a company may not approve a transaction or action that is adverse to the company's interest or that is not performed by the office holder in good faith.

Under the Companies Law, unless the articles of association of a company provide otherwise, a transaction with an office holder, a transaction with a third party in which the office holder has a personal interest, and an action of an office holder that would otherwise be deemed a breach of duty of loyalty requires approval by the board of directors. Our Articles of Association do not provide otherwise. If the transaction or action considered is (i) an extraordinary transaction, (ii) an action of an office holder that would otherwise be deemed a breach of duty of loyalty and may have a material impact on a company's profitability, assets or liabilities, (iii) an undertaking to indemnify or insure an office holder who is not a director, or (iv) for matters considered an undertaking concerning the terms of compensation of an office holder who is not a director, including, an undertaking to indemnify or insure such office holder, then approval by the audit committee is required prior to approval by the board of directors. Arrangements regarding the compensation, indemnification or insurance of a director require the approval of the audit committee, board of directors and shareholders, in that order.

A director who has a personal interest in a matter that is considered at a meeting of the board of directors or the audit committee may generally not be present at the meeting or vote on the matter, unless a majority of the directors or members of the audit committee have a personal interest in the matter or the chairman of the audit committee or board of directors, as applicable, determines that he or she should be present to present the transaction that is subject to approval. If a majority of the directors have a personal interest in the matter, such matter would also require approval of the shareholders of the company.

*Disclosure of personal interests of a controlling shareholder and approval of transactions*

Under the Israeli Companies Law and a recent amendment thereto, the disclosure requirements that apply to an office holder also apply to a controlling shareholder of a public company. See “Audit Committee” for a definition of controlling shareholder. 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, as well as transactions for the provision of services whether directly or indirectly by a controlling shareholder or his or her relative, or a company such controlling shareholder controls, and transactions concerning the terms of engagement of a controlling shareholder or a controlling shareholder’s relative, whether as an office holder or an employee, require the approval of the audit committee, the board of directors and a majority of the shares voted by the shareholders of the company participating and voting on the matter in a shareholders’ meeting. In addition, such shareholder approval must fulfill one of the following requirements:

at least a majority of the shares held by shareholders who have no personal interest in the transaction and are voting at the meeting must be voted in favor of approving the transaction, excluding abstentions; or

the shares voted by shareholders who have no personal interest in the transaction who vote against the transaction represent no more than 2% of the voting rights in the company.

To the extent that any such transaction with a controlling shareholder is for a period extending beyond three years, approval is required once every three years, unless the audit committee determines that the duration of the transaction is reasonable given the circumstances related thereto.

#### *Duties of shareholders*

Under the Israeli Companies Law, a shareholder has a duty to refrain from abusing its power in the company and to act in good faith and in an acceptable manner in exercising its rights and performing its obligations to the company and other shareholders, including, among other things, voting at general meetings of shareholders on the following matters:

an amendment to the articles of association;

an increase in the company's authorized share capital;

a merger;

an increase in the company's authorized share capital; and

the approval of related party transactions and acts of office holders that require shareholder approval.

A shareholder also has a general duty to refrain from discriminating against other shareholders.

The remedies generally available upon a breach of contract will also apply to a breach of the above mentioned duties, and in the event of discrimination against other shareholders, additional remedies are available to the injured shareholder.

In addition, any controlling shareholder, any shareholder that knows that its vote can determine the outcome of a shareholder vote and any shareholder that, under a company's articles of association, has the power to appoint or prevent the appointment of an office holder, or has another power with respect to a company, is under a duty to act with fairness towards the company. The Israeli Companies Law does not describe the substance of this duty except to state that the remedies generally available upon a breach of contract will also apply in the event of a breach of the duty to act with fairness, taking the shareholder's position in the company into account.

## **ORDINARY SHARES**

### ***Rights Attached to Ordinary Shares***

Through March 18, 2009, our authorized share capital was NIS 10,000,000 consisting of 500,000,000 ordinary shares, par value NIS 0.02 per share. On March 18, 2009, pursuant to a shareholder's meeting, the share capital of our company was consolidated and re-divided so that each five (5) shares of NIS 0.02 nominal value was consolidated into one (1) share of NIS 0.1 nominal value so that following such consolidation and re-division, our authorized share capital consisted of 100,000,000 ordinary shares, par value NIS 0.10 per share. In addition, the authorized share capital of our company was increased from NIS 10,000,000 to NIS 70,000,000 divided into 700,000,000 ordinary

shares, NIS 0.10 nominal value. The share consolidation was effected in June 22, 2009.

Holders of ordinary shares have one vote per share, and are entitled to participate equally in the payment of dividends and share distributions and, in the event of our liquidation, in the distribution of assets after satisfaction of liabilities to creditors. No preferred shares are currently authorized. All outstanding ordinary shares are validly issued and fully paid.

### ***Transfer of Shares***

Fully paid ordinary shares are issued in registered form and may be freely transferred under our Articles of Association unless the transfer is restricted or prohibited by another instrument or applicable securities laws.

### ***Dividend and Liquidation Rights***

We may declare a dividend to be paid to the holders of ordinary shares according to their rights and interests in our profits. In the event of our liquidation, after satisfaction of liabilities to creditors, our assets will be distributed to the holders of ordinary shares in proportion to the nominal value of their holdings.

This right may be affected by the grant of preferential dividend or distribution rights, to the holders of a class of shares with preferential rights that may be authorized in the future. Under the Israeli Companies Law, the declaration of a dividend does not require the approval of the shareholders of the company, unless the company's articles of association require otherwise. Our Articles provide that the Board of Directors may declare and distribute dividends without the approval of the shareholders.

### ***Annual and Extraordinary General Meetings***

We must hold our annual general meeting of shareholders each year no later than 15 months from the last annual meeting, at a time and place determined by the Board of Directors, upon at least 21 days' prior notice to our shareholders, to which we need to add an additional three days for notices sent outside of Israel. A special meeting may be convened by request of two directors, 25% of the directors then in office, one or more shareholders holding at least 5% of our issued share capital and at least 1% of our issued voting rights, or one or more shareholders holding at least 5% of our issued voting rights. Notice of a general meeting must set forth the date, time and place of the meeting. Such notice must be given at least 21 days but not more than 45 days prior to the general meeting. The quorum required for a meeting 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 voting rights in the company. 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 (with no need for any notice to the shareholders) or until such other later time if such time is specified in the original notice convening the general meeting, or if we serve notice to the shareholders no less than seven days before the date fixed for the adjourned meeting. If at an adjourned meeting there is no quorum present half an hour after the time set for the meeting, any number participating in the meeting shall represent a quorum and shall be entitled to discuss the matters set down on the agenda for the original meeting. All shareholders who are registered in our registrar on the record date, or who will provide us with proof of ownership on that date as applicable to the relevant registered shareholder, are entitled to participate in a general meeting and may vote as described in "Voting Rights" and "Voting by Proxy and in Other Manners," below.

### ***Voting Rights***

Our ordinary shares do not have cumulative voting rights in the election of directors. As a result, the holders of ordinary shares that represent more than 50% of the voting power represented at a shareholders meeting in which a quorum is present have the power to elect all of our directors, except the external directors whose election requires a special majority.

Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders. Shareholders may vote in person or by proxy. 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 may be authorized in the future.

Under the Israeli Companies Law, unless otherwise provided in the Articles of Association or by applicable law, all resolutions of the shareholders require a simple majority. Our Articles of Association provide that all decisions may be made by a simple majority. See "–Approval of Certain Transactions" above for certain duties of shareholders towards the company.



***Voting by Proxy and in Other Manners***

Our Articles of Association enable a shareholder to appoint a proxy, who need not be a shareholder, to vote at any shareholders meeting. We require that the appointment of a proxy be in writing signed by the person making the appointment or by an attorney authorized for this purpose, and if the person making the appointment is a corporation, by a person or persons authorized to bind the corporation. In the document appointing a proxy, each shareholder may specify how the proxy should vote on any matter presented at a shareholders meeting. The document appointing the proxy shall be deposited in our offices or at such other address as shall be specified in the notice of the meeting not less than 48 hours before the time of the meeting at which the person specified in the appointment is due to vote.

The Israeli Companies Law and our Articles of Association do not permit resolutions of the shareholders to be adopted by way of written consent, for as long as our ordinary shares are publicly traded.

***Limitations on the Rights to Own Securities***

The ownership or voting of ordinary shares by non-residents of Israel is not restricted in any way by our Articles of Association or the laws of the State of Israel, except that nationals of countries which are, or have been, in a state of war with Israel may not be recognized as owners of ordinary shares.

***Anti-Takeover Provisions under Israeli Law***

The Israeli Companies Law permits merger transactions with the approval of each party's board of directors and shareholders. In accordance with the Israeli Companies Law, a merger may be approved at a shareholders meeting by a majority of the voting power represented at the meeting, in person or by proxy, and voting on that resolution. In determining whether the required majority has approved the merger, shares held by the other party to the merger, any person holding at least 25% of the outstanding voting shares or means of appointing the board of directors of the other party to the merger, or the relatives or companies controlled by these persons, are excluded from the vote.

Under the Israeli Companies Law, a merging company must inform its creditors of the proposed merger. Any creditor of a party to the merger may seek a court order blocking the merger, if there is a reasonable concern that the surviving company will not be able to satisfy all of the obligations of the parties to the merger. Moreover, a merger may not be completed until at least 30 days have passed from the time the merger was approved in a general meeting of each of the merging companies, and at least 50 days have passed from the time that a merger proposal was filed with the Israeli Registrar of Companies.



Israeli corporate 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 such acquisition, the purchaser would become a 25% or greater shareholder of the company. This rule does not apply if there is already another shareholder with 25% or greater shares in the company. Similarly, Israeli corporate 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's shareholdings would entitle the purchaser to over 45% of the shares in the company, unless there is a shareholder with 45% or more of the shares in the company. These requirements do not apply if, in general, the acquisition (1) was made in a private placement that received the approval of the company's shareholders; (2) was from a 25% or greater shareholder of the company which resulted in the purchaser becoming a 25% or greater shareholder of the company, or (3) was from a 45% or greater shareholder of the company which resulted in the acquirer becoming a 45% or greater shareholder of the company. These rules do not apply if the acquisition is made by way of a merger. Regulations promulgated under the Israeli Companies Law provide that these tender offer requirements do not apply to companies whose shares are listed for trading external of Israel if, according to the law in the country in which the shares are traded, including the rules and regulations of the stock exchange or which the shares are traded, either:

- there is a limitation on acquisition of any level of control of the company; or
- the acquisition of any level of control requires the purchaser to do so by means of a tender offer to the public.

The Israeli Companies Law provides specific rules and procedures for the acquisition of shares held by minority shareholders, if the majority shareholder holds more than 90% of the outstanding shares. If, as a result of an acquisition of shares, the purchaser will hold more than 90% of a company's outstanding shares, the acquisition must be made by means of a tender offer for all of the outstanding shares. If less than 5% of the outstanding shares are not tendered in the tender offer, all the shares that the purchaser offered to purchase will be transferred to it. The Israeli Companies Law provides for appraisal rights if any shareholder files a request in court within three months following the consummation of a full tender offer. If more than 5% of the outstanding shares are not tendered in the tender offer, then the purchaser may not acquire shares in the tender offer that will cause his shareholding to exceed 90% of the outstanding shares of the company. Israeli tax law treats specified acquisitions, including a stock-for-stock swap between an Israeli company and a foreign company, less favorably than does US tax law. These laws may have the effect of delaying or deterring a change in control of us, thereby limiting the opportunity for shareholders to receive a premium for their shares and possibly affecting the price that some investors are willing to pay for our securities.

### ***Rights of Shareholders***

Under the Israeli Companies Law, our shareholders have the right to inspect certain documents and registers including the minutes of general meetings, the register of shareholders and the register of substantial shareholders, any document held by us that relates to an act or transaction requiring the consent of the general meeting as stated above under "Approval of Certain Transactions," our Articles of Association and our financial statements, and any other document which we are required to file under the Israeli Companies Law or under any law with the Registrar of Companies or the Israeli Securities Authority, and is available for public inspection at the Registrar of Companies or the Securities Authority, as the case may be.

If the document required for inspection by one of our shareholders relates to an act or transaction requiring the consent of the general meeting as stated above, we may refuse the request of the shareholder if in our opinion the request was not made in good faith, the documents requested contain a commercial secret or a patent, or disclosure of the documents could prejudice our good in some other way.

The Israeli Companies Law provides that with the approval of the court any of our shareholders or directors may file a derivative action on our behalf if the court finds the action is *a priori*, to our benefit, and the person demanding the action is acting in good faith. The demand to take action can be filed with the court only after it is serviced to us, and we decline or omit to act in accordance to this demand.

### ***Enforceability of Civil Liabilities***

We are incorporated in Israel and most of our directors and officers and the Israeli experts named in this report reside outside the US. Service of process upon them may be difficult to effect within the US. Furthermore, because substantially all of our assets, and those of our non-US directors and officers and the Israeli experts named herein, are located outside the US, any judgment obtained in the US against us or any of these persons may not be collectible within the US.

We have been informed by our legal counsel in Israel, Kantor & Co., that there is doubt as to the enforceability of civil liabilities under the Securities Act or the Exchange Act, pursuant to original actions instituted in Israel. However, subject to particular time limitations, executory judgments of a US court for monetary damages in civil matters may be enforced by an Israeli court, provided that:

the judgment was obtained after due process before a court of competent jurisdiction, that recognizes and enforces similar judgments of Israeli courts, and the court had authority according to the rules of private international law currently prevailing in Israel;

adequate service of process was effected and the defendant had a reasonable opportunity to be heard;

the judgment is not contrary to the law, public policy, security or sovereignty of the State of Israel and its enforcement is not contrary to the laws governing enforcement of judgments;

the judgment was not obtained by fraud and does not conflict with any other valid judgment in the same matter between the same parties;

the judgment is no longer appealable; and

an action between the same parties in the same matter is not pending in any Israeli court at the time the lawsuit is instituted in the foreign court.

Foreign judgments enforced by Israeli courts generally will be payable in Israeli currency. The usual practice in an action before an Israeli court to recover an amount in a non-Israeli currency is for the Israeli court to render judgment for the equivalent amount in Israeli currency at the rate of exchange in force on the date of the judgment. Under existing Israeli law, a foreign judgment payable in foreign currency may be paid in Israeli currency at the rate of exchange for the foreign currency published on the day before date of payment. Current Israeli exchange control regulations also permit a judgment debtor to make payment in foreign currency. Pending collection, the amount of the judgment of an Israeli court stated in Israeli currency ordinarily may be linked to Israel's consumer price index plus interest at the annual statutory rate set by Israeli regulations prevailing at that time. Judgment creditors must bear the risk of unfavorable exchange rates.

## AMERICAN DEPOSITORY SHARES

We have issued and deposited ordinary shares with Bank Hapoalim B.M., The Bank of New York's custodian in Tel Aviv, Israel. The Bank of New York in turn issued American Depositary Shares, or ADSs, representing American Depositary Shares, or ADSs. One ADS represents an ownership interest in twenty of our ordinary shares. Each ADS also represents securities, cash or other property deposited with The Bank of New York but not distributed to ADS holders. The Bank of New York's Corporate Trust Office is located at 101 Barclay Street, New York, NY 10286, U.S.A. Their principal executive office is located at One Wall Street, New York, NY 10286, U.S.A.

You may hold ADSs either directly or indirectly through your broker or other financial institution. If you hold ADSs directly, you are an ADS holder. This description assumes you hold your ADSs directly. If you hold the ADSs indirectly, you must rely on the procedures of your broker or other financial institution to assert the rights of ADS holders described in this section. You should consult with your broker or financial institution to find out what those procedures are.

Because The Bank of New York will actually hold the ordinary shares, you must rely on it to exercise the rights of a shareholder. The obligations of The Bank of New York are set out in a deposit agreement among us, The Bank of New York and you, as an ADS holder. The agreement and the ADSs are generally governed by New York law.

The following is a summary of the agreement. Because it is a summary, it does not contain all the information that may be important to you. For more complete information, you should read the entire agreement and the ADS. Directions on how to obtain copies of these are provided in the section entitled "Where You Can Find More Information."

### *Share Dividends and Other Distributions*

The Bank of New York has agreed to pay to you the cash dividends or other distributions it or the custodian receives on shares or other deposited securities after deducting its fees and expenses. You will receive these distributions in proportion to the number of shares your ADSs represent.

*Cash.* The Bank of New York will convert any cash dividend or other cash distribution we pay on the shares into U.S. dollars, if it can do so on a reasonable basis and can transfer the U.S. dollars to the U.S. If that is not possible or if any approval from any government or agency thereof is needed and cannot be obtained, the agreement allows The Bank of New York to distribute the foreign currency only to those ADS holders to whom it is possible to do so. It will hold the

foreign currency it cannot convert for the account of the ADS holders who have not been paid. It will not invest the foreign currency and it will not be liable for the interest.

Before making a distribution, any withholding taxes that must be paid under U.S. law will be deducted. The Bank of New York will distribute only whole U.S. dollars and cents and will round fractional cents to the nearest whole cent. If the exchange rates fluctuate during a time when The Bank of New York cannot convert the foreign currency, you may lose some or all of the value of the distribution.

*Shares.* The Bank of New York may distribute new ADSs representing any shares we may distribute as a dividend or free distribution, if we furnish it promptly with satisfactory evidence that it is legal to do so. The Bank of New York will only distribute whole ADSs. It will sell shares which would require it to use a fractional ADS and distribute the net proceeds in the same way as it does with cash. If The Bank of New York does not distribute additional ADSs, each ADS will also represent the new shares.

*Rights to receive additional shares.* If we offer holders of our ordinary shares any rights to subscribe for additional shares or any other rights, The Bank of New York may make these rights available to you. We must first instruct The Bank of New York to do so and furnish it with satisfactory evidence that it is legal to do so. If we do not furnish this evidence and/or give these instructions, and The Bank of New York decides it is practical to sell the rights, The Bank of New York will sell the rights and distribute the proceeds, in the same way as it does with cash. The Bank of New York may allow rights that are not distributed or sold to lapse. In that case, you will receive no value for them. If The Bank of New York makes rights available to you, upon instruction from you, it will exercise the rights and purchase the shares on your behalf. The Bank of New York will then deposit the shares and issue ADSs to you. It will only exercise rights if you pay it the exercise price and any other charges the rights require you to pay.

U.S. securities laws may restrict the sale, deposit, cancellation and transfer of the ADSs issued after exercise of rights. For example, you may not be able to trade the ADSs freely in the U.S. In this case, The Bank of New York may issue the ADSs under a separate restricted deposit agreement which will contain the same provisions as the agreement, except for the changes needed to put the restrictions in place.

*Other Distributions.* The Bank of New York will send to you anything else we distribute on deposited securities by any means it thinks is legal, fair and practical. If it cannot make the distribution in that way, The Bank of New York has a choice. It may decide to sell what we distributed and distribute the net proceeds in the same way as it does with cash or it may decide to hold what we distributed, in which case the ADSs will also represent the newly distributed property.

The Bank of New York is not responsible if it decides that it is unlawful or impractical to make a distribution available to any ADS holders. We have no obligation to register ADSs, shares, rights or other securities under the Securities Act. We also have no obligation to take any other action to permit the distribution of ADSs, shares, rights or anything else to ADS holders. This means that you may not receive the distribution we make on our shares or any value for them if it is illegal or impractical for us to make them available to you.

### ***Deposit, Withdrawal and Cancellation***

The Bank of New York will issue ADSs if you or your broker deposit shares or evidence of rights to receive shares with the custodian upon payment of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees. The Bank of New York will register the appropriate number of ADSs in the names you request and will deliver the ADSs at its office to the persons you request.

You may turn in your ADSs at The Bank of New York's office. Upon payment of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees, The Bank of New York will deliver (1) the underlying shares to an account designated by you and (2) any other deposited securities underlying the ADS at the office of the custodian; or, at your request, risk and expense, The Bank of New York will deliver the deposited securities at its office.

### ***Voting Rights***

You may instruct The Bank of New York to vote the shares underlying your ADSs but only if we ask The Bank of New York to ask for your instructions. Otherwise, you won't be able to exercise your right to vote unless you withdraw

the shares. However, you may not know about the meeting enough in advance to withdraw the shares.

If we ask for your instructions, The Bank of New York will notify you of the upcoming vote and arrange to deliver our voting materials to you. The materials will (1) describe the matters to be voted on and (2) explain how you, on a certain date, may instruct The Bank of New York to vote the shares or other deposited securities underlying your ADSs as you direct. For instructions to be valid, The Bank of New York must receive them on or before the date specified. The Bank of New York will try, as far as practical, subject to Israeli law and the provisions of our Articles of Association, to vote or to have its agents vote the shares or other deposited securities as you instruct. The Bank of New York will only vote or attempt to vote as you instruct. However, if The Bank of New York does not receive your voting instructions, it will deem you to have instructed it to give a discretionary proxy to vote the shares underlying your ADSs to a person designated by us provided that no such instruction shall be deemed given and no such discretionary proxy shall be given with respect to any matter as to which we inform The Bank of New York that (x) we do not wish such proxy given, (y) substantial opposition exists, (z) such matter materially affects the rights of the holders of the shares underlying the ADSs.

We cannot assure you that you will receive the voting materials in time to ensure that you can instruct The Bank of New York to vote your shares. In addition, The Bank of New York and its agents are not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions. This means that you may not be able to exercise your right to vote and there may be nothing you can do if your shares are not voted as you requested.

***Rights of Non-Israeli Shareholders to Vote***

Our ADSs may be freely held and traded pursuant to the General Permit and the Currency Control Law. The ownership or voting of ADSs by non-residents of Israel are not restricted in any way by our Articles of Association or by the laws of the State of Israel.

***Fees and Expenses***

*ADS holders must pay:*

\$5.00 (or less) per 100 ADSs

(or portion thereof)

*For:*

Each issuance of an ADS, including as a result of a distribution of shares or rights or other property.

Each cancellation of an ADS, including if the agreement terminates.

\$0.05 (or less) per ADS

Any cash payment.

Registration or Transfer Fees

Transfer and registration of shares on the share register of the Foreign Registrar from your name to the name of The Bank of New York or its agent when you deposit or withdraw shares.

Conversion of foreign currency to U.S. dollars.

Expenses of The Bank of New York

Cable, telex and facsimile transmission expenses.

Servicing of shares or deposited securities.

\$0.02 (or less) per ADS per calendar year (if the depositary has not collected any cash distribution fee

Depositary services.



during that year)

Taxes and other governmental charges

As necessary The Bank of New York or the Custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes.

A fee equivalent to the fee that would be payable if securities distributed to you had been ordinary shares and the ordinary shares had been deposited for issuance of ADSs

Distribution of securities distributed to holders of deposited securities which are distributed by the depository to ADS holders.

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***Payment of Taxes***

You will be responsible for any taxes or other governmental charges payable on your ADSs or on the deposited securities underlying your ADSs. The Bank of New York may refuse to transfer your ADSs or allow you to withdraw the deposited securities underlying your ADSs until such taxes or other charges are paid. It may apply payments owed to you or sell deposited securities underlying your ADSs to pay any taxes owed and you will remain liable for any deficiency. If it sells deposited securities, it will, if appropriate, reduce the number of ADSs to reflect the sale and pay to you any proceeds, or send to you any property, remaining after it has paid the taxes.

***Reclassifications, Recapitalizations and Mergers***

*If we:*

Change the nominal or par value of our shares;

Reclassify, split up or consolidate any of the deposited securities;

Distribute securities on the shares that are not distributed to you; or

Recapitalize, reorganize, merge, liquidate, sell all or substantially all of our assets, or takes any similar action.

*Then:*

The cash, shares or other securities received by The Bank of New York will become deposited securities. Each ADS will automatically represent its equal share of the new deposited securities. The Bank of New York may, and will if we ask it to, distribute some or all of the cash, shares or other securities it received. It may also issue new ADSs or ask you to surrender your outstanding ADSs in exchange for new ADSs, identifying the new deposited securities.

***Amendment and Termination***

We may agree with The Bank of New York to amend the agreement and the ADSs without your consent for any reason. If the amendment adds or increases fees or charges, except for taxes and other governmental charges or registration fees, cable, telex or facsimile transmission costs, delivery costs or other such expenses, or prejudices an important right of ADS holders, it will only become effective thirty days after The Bank of New York notifies you of the amendment. At the time an amendment becomes effective, you are considered, by continuing to hold your ADS, to

agree to the amendment and to be bound by the ADSs and the agreement is amended.

The Bank of New York will terminate the agreement if we ask it to do so. The Bank of New York may also terminate the agreement if The Bank of New York has told us that it would like to resign and we have not appointed a new depository bank within ninety days. In both cases, The Bank of New York must notify you at least ninety days before termination.

After termination, The Bank of New York and its agents will be required to do only the following under the agreement: (1) advise you that the agreement is terminated, and (2) collect distributions on the deposited securities and deliver shares and other deposited securities upon cancellation of ADSs. After termination, The Bank of New York will, if practical, sell any remaining deposited securities by public or private sale. After that, The Bank of New York will hold the proceeds of the sale, as well as any other cash it is holding under the agreement for the pro rata benefit of the ADS holders that have not surrendered their ADSs. It will not invest the money and will have no liability for interest. The Bank of New York's only obligations will be to account for the proceeds of the sale and other cash. After termination our only obligations will be with respect to indemnification and to pay certain amounts to The Bank of New York.

***Limitations on Obligations and Liability to ADS Holders***

The agreement expressly limits our obligations and the obligations of The Bank of New York, and it limits our liability and the liability of The Bank of New York. We and The Bank of New York:

- are only obligated to take the actions specifically set forth in the agreement without negligence or bad faith;
- are not liable if either is prevented or delayed by law or circumstances beyond their control from performing their obligations under the agreement;
- are not liable if either exercises discretion permitted under the agreement;
- have no obligation to become involved in a lawsuit or other proceeding related to the ADSs or the agreement on your behalf or on behalf of any other party; and
- may rely upon any documents they believe in good faith to be genuine and to have been signed or presented by the proper party.

In the agreement, we and The Bank of New York agree to indemnify each other under certain circumstances.

***Requirements for Depositary Actions***

Before The Bank of New York will issue or register transfer of an ADS, make a distribution on an ADS, or make a withdrawal of shares, The Bank of New York may require payment of stock transfer or other taxes or other governmental charges and transfer or registration fees charged by third parties for the:

- transfer of any shares or other deposited securities;
- production of satisfactory proof of the identity and genuineness of any signature or other information it deems necessary, and

compliance with regulations it may establish, from time to time, consistent with the agreement, including presentation of transfer documents.

The Bank of New York may refuse to deliver, transfer, or register transfers of ADSs generally when the books of The Bank of New York or our books are closed, or at any time if The Bank of New York or we think it advisable to do so. You have the right to cancel your ADSs and withdraw the underlying shares at any time except:

when temporary delays arise because: (1) The Bank of New York or we have closed its transfer books; (2) the transfer of shares is blocked to permit voting at a shareholders' meeting; or (3) we are paying a dividend on the shares; or

when it is necessary to prohibit withdrawals in order to comply with any laws or governmental regulations that apply to ADSs or to the withdrawal of shares or other deposited securities.

This right of withdrawal may not be limited by any other provision of the agreement.

### ***Pre-Release of ADSs***

In certain circumstances, subject to the provisions of the agreement, The Bank of New York may issue ADSs before deposit of the underlying shares. This is called a pre-release of the ADS. The Bank of New York may also deliver shares upon cancellation of pre-released ADSs (even if the ADSs are cancelled before the pre-release transaction has been closed out). A pre-release is closed out as soon as the underlying shares are delivered to The Bank of New York. The Bank of New York may receive ADSs instead of shares to close out a pre-release. The Bank of New York may pre-release ADSs only under the following conditions: (1) before or at the time of the pre-release, the person to whom the pre-release is being made must represent to The Bank of New York in writing that it or its customer owns the shares or ADSs to be deposited; (2) the pre-release must be fully collateralized with cash or other collateral that The Bank of New York considers appropriate; and (3) The Bank of New York must be able to close out the pre-release on not more than five business days' notice. In addition, The Bank of New York will limit the number of ADSs that may be outstanding at any time as a result of prerelease, although The Bank of New York may disregard the limit from time to time, if it thinks it is appropriate to do so.

### ***Inspection of Books of the Depository***

Under the terms of the agreement, holders of ADSs may inspect the transfer books of the depository at any reasonable time, provided that such inspection shall not be for the purpose of communicating with holders of ADSs in the interest of a business or object other than either our business or a matter related to the deposit agreement or ADSs.

### ***Book-Entry Only Issuance - The Depository Trust Company***

The Depository Trust Company, or DTC, New York, New York, will act as securities depository for the ADSs. The ADSs will be represented by one global security that will be deposited with and registered in the name of Cede & Co. (DTC's partnership nominee), or such other name as may be requested by an authorized representative of DTC. This means that we will not issue certificates to you for the ADSs. One global security will be issued to DTC, which will keep a computerized record of its participants (for example, your broker) whose clients have purchased the ADSs. Each participant will then keep a record of its clients. Unless it is exchanged in whole or in part for a certificated security, a global security may not be transferred. However, DTC, its nominees, and their successors may transfer a global security as a whole to one another. Beneficial interests in the global security will be shown on, and transfers of the global security will be made only through, records maintained by DTC and its participants.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the United States Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered under

the provisions of Section 17A of the Exchange Act . DTC holds securities that its participants (direct participants) deposit with DTC. DTC also records the settlement among direct participants of securities transactions, such as transfers and pledges, in deposited securities through computerized records for direct participant's accounts. This eliminates the need to exchange certificates. Direct participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations.

DTC's book-entry system is also used by other organizations such as securities brokers and dealers, banks and trust companies that work through a direct participant. The rules that apply to DTC and its participants are on file with the SEC.

DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation, or DTCC. DTCC is, in turn, owned by a number of DTC's direct participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc. and the National Association of Securities Dealers, Inc.

When you purchase ADSs through the DTC system, the purchases must be made by or through a direct participant, who will receive credit for the ADSs on DTC's records. Since you actually own the ADSs, you are the beneficial owner and your ownership interest will only be recorded on the direct (or indirect) participants' records. DTC has no knowledge of your individual ownership of the ADSs. DTC's records only show the identity of the direct participants and the amount of ADSs held by or through them. You will not receive a written confirmation of your purchase or sale or any periodic account statement directly from DTC. You will receive these from your direct (or indirect) participant. Thus the direct (or indirect) participants are responsible for keeping accurate account of the holdings of their customers like you.

We will wire dividend payments to DTC's nominee, and we will treat DTC's nominee as the owner of the global security for all purposes. Accordingly, we will have no direct responsibility or liability to pay amounts due on the global security to you or any other beneficial owners in the global security.

Any redemption notices will be sent by us directly to DTC, who will in turn inform the direct participants, who will then contact you as a beneficial holder.

It is DTC's current practice, upon receipt of any payment of dividends or liquidation amount, to credit direct participants' accounts on the payment date based on their holdings of beneficial interests in the global securities as shown on DTC's records. In addition, it is DTC's current practice to assign any consenting or voting rights to direct participants whose accounts are credited with preferred securities on a record date, by using an omnibus proxy. Payments by participants to owners of beneficial interests in the global securities, and voting by participants, will be based on the customary practices between the participants and owners of beneficial interests, as is the case with the ADSs held for the account of customers registered in "street name." However, payments will be the responsibility of the participants and not of DTC or us.

ADSs represented by a global security will be exchangeable for certificated securities with the same terms in authorized denominations only if:

DTC is unwilling or unable to continue as depositary or if DTC ceases to be a clearing agency registered under applicable law and a successor depositary is not appointed by us within 90 days; or

we determine not to require all of the ADSs to be represented by a global security.

If the book-entry only system is discontinued, the transfer agent will keep the registration books for the ADSs at its corporate office.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources we believe to be reliable, but we take no responsibility for the accuracy thereof.



## Material Contracts

### *Bio-Gal Ltd.*

On March 18, 2009, we announced that we had entered into an asset purchase agreement with Bio-Gal Ltd. (“**Bio-Gal**”), a Gibraltar private company, for the rights to a use patent on rHuEPO for the prolongation of Multiple Myeloma patients’ survival and improvement of their quality of life. On December 31, 2009, we amended the asset purchase agreement with Bio-Gal, so that XTL could acquire XTEPO Ltd., a special purpose company that was established by Bio-Gal’s shareholders who received from Bio-Gal all of Bio-Gal’s rights on rHuEPO and raised approximately \$1.5 million. We intend to develop rHuEPO for the prolongation of Multiple Myeloma patients’ survival and improvement of their quality of life. Multiple Myeloma is a severe and incurable malignant hematological cancer of plasma cells. In accordance with the terms of the amended asset purchase agreement, we issued to XTEPO’s shareholders ordinary shares representing approximately 69.44% of our then issued and outstanding ordinary share capital. In addition, the parties agreed to cancel a \$10 million cash milestone payment to Bio-Gal upon the successful completion of a Phase 2 clinical trial, which was under the original asset purchase agreement. We are obligated to pay 1% royalties on net sales of the product, as well as a fixed royalty payment in the total amount of \$350,000 upon the successful completion of Phase 2. Such payment of \$350,000 mentioned above shall be made to Yeda upon the earlier of (i) six months from the successful completion of the Phase 2 or (ii) the completion of a successful fundraising by XTL or XTEPO at any time after the completion of the Phase 2 of at least \$2 million. On August 3, 2010, the Bio-Gal transaction was completed according to the outline signed by the parties to the agreement on December 31, 2009, after all the prerequisites had been met, including, among other things, the signing of an agreement with the Israeli Tax Authority regarding the tax exemption granted to the share swap transaction pursuant to article 104 and 103 to the Israeli tax ordinance (Revised), 1961. (See note 14c to the consolidated financial statements: Intangible Asset).

### *MinoGuard Ltd.*

On March 24, 2011, we entered into a Memorandum of Understanding with MinoGuard, pursuant to which we shall acquire the exclusive rights to SAM-101 by obtaining an exclusive license to use MinoGuard’s entire technology. SAM-101 is based on a combination of anti-psychotic drugs with minocycline, a recognized medicinal compound. On November 30, 2011, we received a worldwide exclusive license from MinoGuard under which we shall develop and commercialize MinoGuard’s technology for the treatment of psychotic disorders focusing on Schizophrenia. Under the agreement, we are to conduct clinical trials, develop, register, market, distribute and sell the drugs that will emerge from MinoGuard’s technology, with no limitations for a specific disorder. In consideration, we shall pay MinoGuard accumulated clinical development and marketing approvals milestone-based payments of approximately \$2.5 million. In addition, we will pay MinoGuard royalty-based payments on products that are based on the technology, equal to 3.5% of its net sales and/or percentage from the Company third-party out-license receipts in the range of 7.5%-20% according to the clinical phase of the drug at the time of an out-license transaction. It should be noted that the Company has the sole discretion to pay any of the above amounts in cash or by way of issuing ordinary shares of the Company to MinoGuard. In addition to the above payments, and in accordance with the above agreement, since as of June 30, 2013, XTL had not commenced a phase 2 clinical trial, we have paid MinoGuard an annual license fee, by

way of the issuance of 175,633 ordinary shares of the Company, representing a value of \$45,000, for the 12 month period between July 1, 2013 and June 30, 2014. On September 3, 2014, the Company issued an additional 889,822 ordinary shares, representing a value of \$135,000, for the 12 month period between July 1, 2014 and June 30, 2015. Such annual payments will increase by \$90,000 per annum, up to \$675,000 for the eighth year of license or until the agreement is terminated.

The term of the license commenced upon the signing of the license agreement will be for an unlimited period. Upon the expiration of the last payment obligation of XTL the license will be considered perpetual and fully paid up.

The license may be terminated by either XTL without cause upon 30 days' notice, or by the licensor for no commercial progress in the event that by the date of June 30, 2013 commencement of phase 2 clinical trial with respect to the licensed product has not occurred, we have not entered into a Sublicense Agreement with a substantial third party or we have not paid the annual license fee.

### ***hCDR1***

On January 7, 2014, the Company entered into a licensing agreement with Yeda to research, develop, and commercialize hCDR1, a Phase II-ready asset for the treatment of SLE, among other indications. In consideration, the Company is responsible for a patent expense reimbursement in six installments totaling approximately \$400,000. The Company is required to make milestone payments of \$2.2 million: \$200,000 upon starting Phase III, \$1 million upon U.S. Food and Drug Administration approval and \$250,000 for regulatory approval in each of China and three of the European Union's Group of Six. In addition, the Company will pay 2-3% royalties of annual net sales and sublicense fees of 15-20% of whatever the Company receives from any sub-licensee.

Lupus is a debilitating disease affecting approximately five million people worldwide according to the Lupus Foundation of America. hCDR1, is a peptide and acts as a disease-specific treatment to modify the SLE-related autoimmune process. It does so by specific upstream immunomodulation through the generation of regulatory T cells, reducing inflammation and resuming immune balance. Prior to being licensed to the Company by Yeda, hCDR1 was licensed to Teva Pharmaceutical Industries ("Teva"), which performed two placebo controlled Phase I trials and a placebo controlled Phase II trial called the PRELUDE trial. The studies consisted of over 400 patients, demonstrating that hCDR1 is well tolerated by patients and has a favorable safety profile. The PRELUDE trial did not achieve its primary efficacy endpoint based on the SLEDAI scale, resulting in Teva returning the asset to Yeda. However, the PRELUDE trial showed encouraging results in its secondary clinical endpoint, the BILAG index, and, in fact, the 0.5 mg weekly dose showed a substantial effect. Multiple post-hoc analyses also showed impressive results for this dose using the BILAG index. The Company plans that such dose be the focus of the clinical development plan moving forward. Subsequent to Teva's return of the program to Yeda, the FDA directed that the primary endpoint in future trials for Lupus therapies, including those for hCDR1, should be based on either the BILAG index or the SRI. Given the FDA's recommendation and the positive findings from the PRELUDE trial (which showed a substantial effect in the BILAG index), the Company intends to initiate a new Phase II clinical trial, which will include the 0.5 mg (and a 0.25 mg) weekly dose of hCDR1.

### ***Proteologics***

On November 21, 2012, in an off-market transaction, we purchased from Teva 4,620,356 Ordinary shares of NIS 1.0 par value each of Proteologics, representing Teva's entire stake in Proteologics and approximately 31.35% of Proteologics' issued and outstanding share capital, for approximately NIS 6.5 million (approximately \$ 1.7 million). Proteologics is a public company whose shares are listed on the TASE and was engaged at the time of acquisition in the discovery and development of drugs comprised of various components of the UBIQUITIN system, which was discovered by Dr. Avram Hershko and Dr. Aaron Ciechanover, both 2004 Nobel Prize laureates in Chemistry for the discovery of the UBIQUITIN system.

On August 22, 2013, Proteologics' board of directors resolved to terminate Proteologics' operations effective immediately.

On September 11, 2013, the Company entered into an agreement for the purchase of another 14.13% of the shares of Proteologics from Aurum Ventures MKI Ltd. ("Aurum") in consideration for the issuance of 3,031,299 shares of NIS 0.1 par value each of the Company to Aurum. On September 12, 2013, the Company signed an agreement with Zmiha Investment House Ltd. ("Zmiha") for the sale of its entire investment in Proteologics, representing 44.95% of Proteologics' issued and outstanding share capital as of the date of the agreement in consideration of approximately \$ 3.4 million (approximately NIS 12 million). According to the agreement, on the consummation date, the Company received an amount of approximately \$ 2.7 million (approximately NIS 9.6 million) and the balance was held in escrow until the completion of an inspection process by an inspector and the execution of a stay of proceeding pursuant to Section 350 to the Israeli Companies Law in Proteologics. As of the date of this report the entire considerations has been delivered to the Company and no amount remains in escrow.

### **Exchange Controls**

Under Israeli Law, Israeli non-residents who purchase ordinary shares with certain non-Israeli currencies (including dollars) may freely repatriate in such non-Israeli currencies all amounts received in Israeli currency in respect of the ordinary shares, whether as a dividend, as a liquidating distribution, or as proceeds from any sale in Israel of the ordinary shares, provided in each case that any applicable Israeli income tax is paid or withheld on such amounts. The conversion into the non-Israeli currency must be made at the rate of exchange prevailing at the time of conversion.

## **Taxation**

The following discussion summarizes certain Israeli and US federal income tax consequences that may be material to our shareholders, but is not intended, and should not be construed, as legal or professional tax advice and does not exhaust all possible tax considerations that may be relevant to holders of our ordinary shares. This discussion is based on existing law, judicial authorities and administrative interpretations, all of which are subject to change or differing interpretations, possibly with retroactive effect. This summary does not purport to be a complete analysis of all potential tax consequences of owning our ordinary shares. In particular, this discussion does not take into account the specific circumstances of any particular holder or holders who may be subject to special rules, such as tax-exempt entities, broker-dealers, shareholders subject to Alternative Minimum Tax, shareholders that actually or constructively own 10% or more of our voting securities, shareholders that hold ordinary shares or ADSs as part of straddle or hedging or conversion transaction, traders in securities that elect mark to market, banks and other financial institutions or partnerships or other passthrough entities.

*We urge shareholders to consult their own tax advisors as to the potential US, Israeli, or other tax consequences of the purchase, ownership and disposition of ordinary shares and ADSs, including, in particular, the effect of any foreign, state or local taxes. For purposes of the entire Taxation discussion, we refer to ordinary shares and ADSs collectively as ordinary shares.*

### ***Israeli Tax Considerations***

The following discussion refers to the current tax law applicable to companies in Israel, with special reference to its effect on us. This discussion also includes specified Israeli tax consequences to holders of our ordinary shares and Israeli Government programs benefiting us.

### **Corporate Tax Rate**

The income of the Company is subject to corporate tax at the regular rate; the guidance of the amendment to the Income Tax Ordinance, 2005 from August 2008 prescribes a gradual reduction in the corporate tax rates and the resulting corporate tax rates starting 2008 are as follows: 2008 - 27%, 2009 - 26% and 2010 and thereafter - 25%.

On July 14, 2009, the “Knesset” (Israeli Parliament) passed the Law for Economic Efficiency (Amended Legislation for Implementing the Economic Plan for 2009 and 2010), 2009, which prescribes, among other things, an additional gradual reduction in the corporate tax rates starting 2011 to the following tax rates: 2011 - 24%, 2012 - 23%, 2013 -

22%, 2014 - 21%, 2015 - 20%, 2016 and thereafter - 18%.

In December 2011, following the enactment of the Law for Changing the Tax Burden (Legislative Amendments), 2011 (hereafter – “Tax Burden Distribution Law”), the phased reduction in the corporate tax was eliminated, and the corporate tax rate in 2012 and thereafter was set to 25%.

On August 5, 2013, the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013-2014), 2013 (the “Law”) was published in the Government’s records. Among other things, the Law prescribes from the 2014 tax year and thereafter, an increase in the Israeli corporate tax rate to 26.5% (instead of 25%).

Capital gains in the hands of the Company and its Israeli subsidiaries are taxable according to the corporate tax rate applicable in the tax year.

#### **Tax Benefits for Research and Development**

Israeli tax law allows, under specific conditions, a tax deduction in the year incurred for expenditures, including capital expenditures, relating to scientific research and development projects, if the expenditures are approved by the relevant Israeli government ministry, determined by the field of research, and the research and development is for the promotion of the company and is carried out by or on behalf of the company seeking the deduction. Expenditures not so approved are deductible over a three-year period. In the past, expenditures that were made out of proceeds made available to us through government grants were automatically deducted during a one year period.

#### **Israeli Estate and Gift Taxes**

Israel does not currently impose taxes on inheritance or bona fide gifts. For transfers of assets by inheritance or gift that would normally be subject to capital gains tax or land appreciation tax, the recipient’s tax cost basis and date of purchase are generally deemed to be the same as those for the transferor of the property.

**Capital Gains Tax on Sales of our Ordinary Shares by Both Residents and Non-Residents of Israel**

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 the inflationary surplus and the real gain. The inflationary surplus is the portion of the total capital gain, which is equivalent to the increase of the relevant asset's purchase price attributable to the increase in the Israeli consumer price index from the date of purchase to the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus. A non-resident that invests in taxable assets with foreign currency may elect to calculate the inflationary amount by using such foreign currency.

Non-Israeli residents will be exempt from Israeli capital gains tax on any gains derived from the sale of shares publicly traded on a stock exchange recognized by the Israeli Ministry of Finance (including the Tel-Aviv Stock Exchange and Nasdaq), provided such shareholders did not acquire their shares prior to an initial public offering and that such capital gains are not derived by a permanent establishment of the foreign resident in Israel. Notwithstanding the foregoing, dealers in securities in Israel are taxed at the regular tax rates applicable to business income. However, Non-Israeli corporations will not be entitled to such exemption if an Israeli resident (1) has a controlling interest of 25% or more in such non-Israeli corporation, or (2) is the beneficiary of, or is entitled to, 25% or more of the revenue or profits of such non-Israeli corporation, whether directly or indirectly. In any event, the provisions of the tax reform shall not affect the exemption from capital gains tax for gains accrued before January 1, 2003, as described in the previous paragraph.

The capital gains tax imposed on Israeli tax resident individuals on the sale of securities was 20%. With respect to an Israeli tax resident individual who is a "substantial shareholder" on the date of sale of the securities or at any time during the 12 months preceding such sale, the capital gains tax rate was increased to 25%. In December 2011, following the enactment of the Tax Burden Distribution Law, the tax rates mentioned above were increased to 25% and 30%, respectively, from 2012 and thereafter. A "substantial shareholder" is defined as someone who alone, or together with another person, holds, directly or indirectly, at least 10% in one or all of any of the means of control in the corporation. With respect to Israeli tax resident corporate investors, capital gains tax at the regular corporate rate will be imposed on such taxpayers on the sale of traded shares.

In addition, pursuant to the Convention Between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income, as amended (the "United States- Israel Tax Treaty"), the sale, exchange or disposition of ordinary shares by a person who qualifies as a resident of the US within the meaning of the United States-Israel Tax Treaty and who is entitled to claim the benefits afforded to such person by the United States-Israel Tax Treaty (a "Treaty United States Resident") generally will not be subject to the Israeli capital gains tax unless such Treaty United States Resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the twelve- month period preceding such sale, exchange or disposition, subject to certain conditions or if the capital gains from such sale are considered as business income attributable to a permanent establishment of the US resident in Israel. However, under the United States-Israel Tax Treaty, such "Treaty United States Resident"

would be permitted to claim a credit for such taxes against the US federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in US laws applicable to foreign tax credits.

### **Taxation of Dividends**

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel.

The tax rate imposed on dividends distributed by an Israeli company to Israeli tax resident individuals or to non-Israeli residents was set at a rate of 20%. With respect to “substantial shareholders,” as defined above, the applicable tax rate was 25%. In December 2011, following the enactment of the Tax Burden Distribution Law, the tax rates mentioned above were increased to 25% and 30%, respectively, from 2012 and thereafter. The taxation of dividends distributed by an Israeli company to another Israeli corporate tax resident is generally exempt from tax.

In any case, dividends distributed from the taxable income attributable to an Approved Enterprise (as defined above), to both Israeli tax residents and non-Israeli residents remains subject to a 15% tax rate.

Notwithstanding, dividends distributed by an Israeli company to Israeli tax resident individuals or to non-Israeli residents were subject to a 20% withholding tax, which was increased to 25% from 2012 and thereafter, following the enactment of the Tax Burden Distribution Law (15% in the case of dividends distributed from the taxable income attributable to an Approved Enterprise), unless a lower rate is provided in a treaty between Israel and the shareholder’s country of residence. Dividends distributed by an Israeli company to another Israeli tax resident company are generally exempt, unless such dividends are distributed from taxable income attributable to an Approved Enterprise, in which case such dividends are taxed at a rate of 15%, or unless such dividends are distributed from income that was not sourced in Israel, in which case such dividends are taxed at a rate of 25%.



Under the US-Israel Tax Treaty, the maximum Israeli tax and withholding tax on dividends paid to a holder of ordinary shares who is a resident of the US is generally 25%, but is reduced to 12.5% if the dividends are paid to a corporation that holds in excess of 10% of the voting rights of a company during the company's taxable year preceding the distribution of the dividend and the portion of the company's taxable year in which the dividend was distributed. Dividends of an Israeli company derived from the income of an Approved Enterprise will still be subject to a 15% dividend withholding tax; if the dividend is attributable partly to income derived from an Approved Enterprise, and partly to other sources of income, the withholding rate will be a blended rate reflecting the relative portions of the two types of income. A non-resident of Israel who has dividend income derived from or accrued in Israel, from which tax was withheld at the source, is generally exempt from the duty to file tax returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer.

*US Federal Income Tax Considerations*

**TO ENSURE COMPLIANCE WITH US TREASURY DEPARTMENT CIRCULAR 230, PROSPECTIVE HOLDERS OF ORDINARY SHARES ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF US FEDERAL TAX ISSUES IN THIS MEMORANDUM IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY HOLDERS OF ORDINARY SHARES FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON SUCH HOLDERS UNDER THE INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE "CODE"); (B) SUCH DISCUSSION IS WRITTEN IN CONNECTION WITH THE PROMOTION OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) PROSPECTIVE HOLDERS OF ORDINARY SHARES SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.**

The following discussion applies only to a holder of our ordinary shares who qualifies as a “US holder”. For purposes of this discussion a “US holder” is a beneficial owner of our ordinary shares that is for US federal income tax purposes:

· an individual who is a US citizen or US resident alien;

· a corporation (or other entity taxable as a corporation for US federal income tax purposes) that was created or organized under the laws of the US, any state thereof or the District of Columbia;

· an estate whose income is subject to US federal income taxation regardless of its source; or

· a trust (i) if a US court is able to exercise primary supervision over the administration of the trust and one or more “United States persons” (as defined in the Code) have the authority to control all substantial decisions of the trust, or (ii) if the trust has a valid election in effect under applicable Treasury Regulations to be treated as a “United States person.”

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended, which we refer to as the Code, current and proposed Treasury regulations promulgated under the Code, and administrative and judicial decisions as of the date of this report, all of which are subject to change or differing interpretation, possibly on a retroactive basis. This discussion does not address any aspect of state, local or non-US tax laws. Except where noted, this discussion addresses only those holders who hold our shares as capital assets. This discussion does not purport to be a comprehensive description of all of the tax considerations that may be relevant to US holders entitled to special treatment under US federal income tax laws, for example, financial institutions, insurance companies, tax-exempt organizations and broker/dealers, and it does not address all aspects of US federal income taxation that may be relevant to any particular shareholder based on the shareholder’s individual circumstances. In particular, this discussion does not address the potential application of the alternative minimum tax, or the special US federal income tax rules applicable in special circumstances, including to US holders who:

· have elected mark-to-market accounting;

· hold our ordinary shares as part of a straddle, hedge or conversion transaction with other investments;

· own directly, indirectly or by attribution at least 10% of our voting power;

· are tax exempt entities;

· are persons who acquire shares in connection with employment or other performance of services; and

have a functional currency that is not the US dollar.

Additionally, this discussion does not consider the tax treatment of partnerships or persons who hold ordinary shares through a partnership or other pass-through entity or the possible application of US federal gift or estate taxes.

Each prospective shareholder is urged to consult its tax advisor regarding the particular tax consequences to such holder of ownership and disposition of our shares, as well as any tax consequences that may arise under the laws of any other relevant foreign, state, local, or other taxing jurisdiction.

### **Taxation of Distributions Paid on Ordinary Shares**

Subject to the description of the passive foreign investment company rules below, a US holder will be required to include in gross income as ordinary income from sources outside of the US the amount of any distribution paid on ordinary shares, including any Israeli taxes withheld from the amount paid, to the extent the distribution is paid out of our current or accumulated earnings and profits as determined for US federal income tax purposes. Distributions in excess of these earnings and profits will be applied against and will reduce the US holder's basis in the ordinary shares and, to the extent in excess of this basis, will be treated as gain from the sale or exchange of ordinary shares.

Certain dividend income may be eligible for a reduced rate of taxation. Dividend income will be taxed to a non-corporate holder at the applicable long-term capital gains rate if the dividend is received from a “qualified foreign corporation,” and the shareholder of such foreign corporation holds such stock for more than 60 days during the 121 day period that begins on the date that is 60 days before the ex-dividend date for the stock. The holding period is tolled for any days on which the shareholder has reduced his risk of loss with respect to the stock. A “qualified foreign corporation” is either a corporation that is eligible for the benefits of a comprehensive income tax treaty with the US or a corporation whose stock, the shares of which are with respect to any dividend paid by such corporation, is readily tradable on an established securities market in the United States (including, for this purpose, ADSs traded on a securities market in the United States with respect to the foreign corporation’s shares). However, a foreign corporation will not be treated as a “qualified foreign corporation” if it is a passive foreign investment company (as discussed below) for the year in which the dividend was paid or the preceding year. Distributions of current or accumulated earnings and profits paid in foreign currency to a US holder will be includible in the income of a US holder in a US dollar amount calculated by reference to the exchange rate in effect on the day the distribution is received by the US holder (or, in the case of ADSs, on the day the distribution is received by the depository). A US holder that receives a foreign currency distribution and converts the foreign currency into US dollars subsequent to receipt will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the US dollar, which will generally be US source ordinary income or loss.

As described above, we will generally be required to withhold Israeli income tax from any dividends paid to holders who are not resident in Israel. See “- Israeli Tax Considerations—Taxation of Dividends” above. If a US holder receives a dividend from us that is subject to Israeli withholding, the following would apply:

You must include the gross amount of the dividend, not reduced by the amount of Israeli tax withheld, in your US taxable income.

You may be able to claim the Israeli tax withheld as a foreign tax credit against your US income tax liability. However, to the extent that 25% or more of our gross income from all sources was effectively connected with the conduct of a trade or business in the US (or treated as effectively connected, with limited exceptions) for a three-year period ending with the close of the taxable year preceding the year in which the dividends are declared, a portion of this dividend will be treated as US source income, possibly reducing the allowable foreign tax.

The foreign tax credit is subject to significant and complex limitations. Generally, the credit can offset only the part of your US tax attributable to your net foreign source passive income. Additionally, if we pay dividends at a time when 50% or more of our stock is owned by US persons, you may be required to treat the part of the dividend attributable to US source earnings and profits as US source income, possibly reducing the allowable credit.

A US holder will be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on the ordinary shares to the extent the US holder has not held the ordinary shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date or, alternatively, to the extent the US holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a US holder has substantially diminished its risk of loss on the ordinary shares are not counted

toward meeting the 16-day holding period required by the statute.

If you do not elect to claim foreign taxes as a credit, you will be entitled to deduct the Israeli income tax withheld from your XTL dividends in determining your taxable income.

Individuals who do not claim itemized deductions, but instead utilize the standard deduction, may not claim a deduction for the amount of the Israeli income taxes withheld.

If you are a US corporation holding our stock, the general rule is that you cannot claim the dividends-received deduction with respect to our dividends. There is an exception to this rule if you own at least 10% of our ordinary shares (by vote) and certain conditions are met.

Special rules, described below, apply if we are a passive foreign investment company.

### **Taxation of the Disposition of Ordinary Shares**

Subject to the description of the passive foreign investment company rules below, upon the sale, exchange or other disposition of our ordinary shares, a US holder will recognize capital gain or loss in an amount equal to the difference between the US holder's basis in the ordinary shares, which is usually the cost of those shares, and the amount realized on the disposition. Capital gain from the sale, exchange or other disposition of ordinary shares held more than one year is long-term capital gain and is eligible for a reduced rate of taxation for non-corporate holders. In general, gain realized by a US holder on a sale, exchange or other disposition of ordinary shares generally will be treated as US source income for US foreign tax credit purposes. A loss realized by a US holder on the sale, exchange or other disposition of ordinary shares is generally allocated to US source income. However, regulations require the loss to be allocated to foreign source income to the extent certain dividends were received by the taxpayer within the 24-month period preceding the date on which the taxpayer recognized the loss. The deductibility of a loss realized on the sale, exchange or other disposition of ordinary shares is subject to limitations for both corporate and individual shareholders.

A US holder that uses the cash method of accounting calculates the US dollar value of the proceeds received from a sale of ordinary shares as of the date that the sale settles, and will generally have no additional foreign currency gain or loss on the sale, while a US holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the trade date and may therefore realize foreign currency gain or loss, unless the US holder has elected to use the settlement date to determine its proceeds of sale for purposes of calculating this foreign currency gain or loss. In addition, a US holder that receives foreign currency upon disposition of our ordinary shares and converts the foreign currency into US dollars subsequent to receipt will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the US dollar, which will generally be US source ordinary income or loss.

### **Tax Consequences if we are a Passive Foreign Investment Company**

Special federal income tax rules apply to the timing and character of income received by a US holder of a PFIC. We will be a PFIC if either 75% or more of our gross income in a tax year is passive income or the average percentage of our assets (by value) that produce or are held for the production of passive income in a tax year is at least 50%. The IRS has indicated that cash balances, even if held as working capital, are considered to be assets that produce passive income. Therefore, any determination of PFIC status will depend upon the sources of our income, and the relative values of passive and non-passive assets, including goodwill. Furthermore, because the goodwill of a publicly-traded corporation is largely a function of the trading price of its shares, the valuation of that goodwill is subject to significant change throughout each year. A determination as to a corporation's status as a PFIC must be made annually. We believe that we were likely not a PFIC for the taxable years ended December 31, 2012, 2011, 2010 and 2009. Although such a determination is fundamentally factual in nature and generally cannot be made until the close of the applicable taxable year, based on our current operations, we believe that we were likely not classified as a PFIC for the taxable year ended December 31, 2013. Notwithstanding the above, we may be a PFIC in subsequent years. In addition, even though we may not be a PFIC in any one particular year, if we have qualified as a PFIC in a prior year,

the special PFIC tax regime will continue to apply.

If we are classified as a PFIC, a special tax regime would apply to both (a) any “excess distribution” by us (generally, the US holder’s ratable share of distributions in any year that are greater than 125% of the average annual distributions received by such US holder in the three preceding years or its holding period, if shorter) and (b) any gain recognized on the sale or other disposition of your ordinary shares. Under this special regime, any excess distribution and recognized gain would be treated as ordinary income and the federal income tax on such ordinary income would be determined as follows: (i) the amount of the excess distribution or gain would be allocated ratably over the US holder’s holding period for our ordinary shares; (ii) US federal income tax would be determined for the amounts allocated to the first year in the holding period in which we were classified as a PFIC and for all subsequent years (except the year in which the excess distribution was received or the sale occurred) by applying the highest applicable tax rate in effect in the year to which the income was allocated; (iii) an interest charge would be added to this tax, calculated by applying the underpayment interest rate to the tax for each year determined under the preceding sentence from the due date of the income tax return for such year to the due date of the return for the year in which the excess distribution or sale occurs; and (iv) amounts allocated to a year prior to the first year in the US holder’s holding period in which we were classified as a PFIC or to the year in which the excess distribution or the disposition occurred would be taxed as ordinary income but without the imposition of an interest charge.

A US holder may generally avoid the PFIC “excess distribution” regime by electing to treat his PFIC shares as a “qualified electing fund.” If a US holder elects to treat PFIC shares as a qualified electing fund, also known as a “QEF Election,” the US holder must include annually in gross income (for each year in which PFIC status is met) his *pro rata* share of the PFIC’s ordinary earnings and net capital gains, whether or not such amounts are actually distributed to the US holder. A US holder may make a QEF Election with respect to a PFIC for any taxable year in which he was a shareholder. A QEF Election is effective for the year in which the election is made and all subsequent taxable years of the US holder. Procedures exist for both retroactive elections and the filing of protective statements. A US holder making the QEF Election must make the election on or before the due date, as extended, for the filing of the US holder’s income tax return for the first taxable year to which the election will apply.

A QEF Election is made on a shareholder-by-shareholder basis. A US holder must make a QEF Election by completing Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, and attaching it to the holder’s timely filed US federal income tax return. We have complied with the record-keeping and reporting requirements that are a prerequisite for US holders to make a QEF Election for the 2007 and 2006 tax years. While we plan to continue to comply with such requirements, if, in the future, meeting those record-keeping and reporting requirements becomes onerous, we may decide, in our sole discretion, that such compliance is impractical and will so notify US holders.

Alternatively, a US holder may also generally avoid the PFIC regime by making a so-called “mark-to-market” election. Such an election may be made by a US holder with respect to ordinary shares owned at the close of such holder’s taxable year, provided that we are a PFIC and the ordinary shares are considered “marketable stock.” The ordinary shares will be marketable stock if they are regularly traded on a national securities exchange that is registered with the Securities and Exchange Commission, or the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or an equivalent regulated and supervised foreign securities exchange.

If a US holder were to make a mark-to-market election with respect to ordinary shares, such holder generally will be required to include in its annual gross income the excess of the fair market value of the PFIC shares at year-end over such shareholder’s adjusted tax basis in the ordinary shares. Such amounts will be taxable to the US holder as ordinary income, and will increase the holder’s tax basis in the ordinary shares. Alternatively, if in any year, a United States holder’s tax basis exceeds the fair market value of the ordinary shares at year-end, then the US holder generally may take an ordinary loss deduction to the extent of the aggregate amount of ordinary income inclusions for prior years not previously recovered through loss deductions and any loss deductions taken will reduce the shareholder’s tax basis in the ordinary shares. Gains from an actual sale or other disposition of the ordinary shares with a “mark-to-market” election will be treated as ordinary income, and any losses incurred on an actual sale or other disposition of the ordinary shares will be treated as an ordinary loss to the extent of any prior “unreversed inclusions” as defined in Section 1296(d) of the Code.

The mark-to-market election is made on a shareholder-by-shareholder basis. The mark-to-market election is made by completing Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, and attaching it to the holder’s timely filed US federal income tax return for the year of election. Such election is



effective for the taxable year for which made and all subsequent years until either (a) the ordinary shares cease to be marketable stock or (b) the election is revoked with the consent of the IRS.

*In view of the complexity of the issues regarding our treatment as a PFIC, US shareholders are urged to consult their own tax advisors for guidance as to our status as a PFIC.*

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

US holders generally are subject to information reporting requirements with respect to dividends paid in the US on ordinary shares. Existing regulations impose information reporting and back-up withholding on dividends paid in the US on ordinary shares and on proceeds from the disposition of ordinary shares unless the US holder provides IRS Form W-9 or otherwise establishes an exemption.

Prospective investors should consult their tax advisors concerning the effect, if any, of these Treasury regulations on an investment in ordinary shares. Back-up withholding is not an additional tax. The amount of any back-up withholding will be allowed as a credit against a holder's US federal income tax liability and may entitle the holder to a refund, provided that specified required information is furnished to the IRS on a timely basis.

## Documents on Display

We voluntarily file reports and other information with the SEC under the Exchange Act and the regulations thereunder applicable to foreign private issuers. You may inspect and copy reports and other information filed by us with the SEC at the SEC's public reference facilities described below. Although as a foreign private issuer we are not required to file periodic information as frequently or as promptly as US companies, we generally announce publicly our interim and year-end results promptly on a voluntary basis and will file that periodic information with the SEC under cover of Form 6-K. 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 in Section 16 of the Exchange Act.

You may read and copy any document we file or furnish with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference facilities. You can review our SEC filings and the registration statement by accessing the SEC's internet site at <http://www.sec.gov>.

We also maintain a website at <http://www.xtlbio.com>, but information contained on our website does not constitute a part of this report and is not incorporated by reference into this report.

## Item 11. Quantitative and Qualitative Disclosures About Market Risk

*Interest Rate Risk.* The primary objective of our investment activities is to preserve principal while maximizing our income from investments and minimizing our market risk. We invest in bank deposits in accordance with our investment policy. As of December 31, 2014, our portfolio of financial instruments consists of cash and cash equivalents, short-term bank deposits with multiple institutions. The average duration of all of our investments held as of December 31, 2014, was less than one year. Due to the short-term nature of these investments, we believe we have no material exposure to interest rate risk arising from our investments.

*Foreign Currency and Inflation Risk.* We generate most of our revenues and hold most of our cash, cash equivalents and bank deposits in US dollars. While a substantial amount of our operating expenses are in US dollars, we incur a portion of our expenses in New Israeli Shekels. In addition, we also pay for some of our services and supplies in the local currencies of our suppliers, as our head office is located in Israel. As a result, we are exposed to the risk that the US dollar will be devalued against the New Israeli Shekel or other currencies, and as a result our financial results could be harmed if we are unable to guard against currency fluctuations in Israel or other countries in which services and supplies are obtained in the future. Accordingly, we may enter into currency hedging transactions to decrease the risk of financial exposure from fluctuations in the exchange rates of currencies. The Company's treasury risk management policy, is to hold NIS-denominated cash and cash equivalents and short-term deposits in the amount of the anticipated NIS-denominated liabilities for six consecutive months from time to time and this in line with the directives of the Company's Board. These measures, however, may not adequately protect us from the adverse effects of inflation in Israel. In addition, we are exposed to the risk that the rate of inflation in Israel will exceed the rate of devaluation of the New Israeli Shekel in relation to the dollar or that the timing of any devaluation may lag behind inflation in Israel.

As of December 31, 2014, had the Group's functional currency weakened by 10% against the NIS with all other variables remaining constant, post-tax loss for the year would have been \$ 85 thousand lower (2013 – post-tax loss approximately \$ 157 thousand lower; 2012 - post-tax loss approximately \$ 89 thousand lower), mainly as a result of exchange rate changes on translation of other accounts receivable, net and exchange rate changes on NIS-denominated cash and cash equivalents and short-term deposits. Loss was more sensitive to movement in the exchange rate in relation to the NIS in 2014 than in 2013 mainly because of the decreased amount of the NIS-denominated balances in the items of cash, receivables and payables of the Group, as December 31, 2013, balances included NIS denominated receivables from the sale of Proteologics.

*Credit Risk.* Credit risks are managed at the Group level. The Group has no significant concentrations of credit risk. The Group has a policy to ensure collection through sales of its products to wholesalers with an appropriate credit history and through retail sales in cash or by credit card.

*Liquidity Risk.* Cash flow forecasting is performed by the Group's management both in the entities of the Group and aggregated by the Group. The Group's management monitors rolling forecasts of the Group's liquidity requirements to ensure it has sufficient cash to meet operations. The Group currently does not use credit facilities. Forecasting takes into consideration several factors such as raising capital to finance operations and certain liquidity ratios that the Group strives to achieve.

Surplus cash held to finance operating activities is invested in interest bearing current accounts, time deposits and other similar channels. These channels were chosen by reference to their appropriate maturities or liquidity to provide sufficient cash balances to the Group as determined by the abovementioned forecasts.

As of December 31, 2014 and 2013, the maturity of the Group's financial liabilities is less than one year from each of the reporting dates.

**Item 12. Description of Securities Other than Equity Securities**

Not applicable.

## PART II

### Item 13. Defaults, Dividend Arrearages and Delinquencies

Not applicable.

### Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

Not applicable.

### Item 15. Controls and Procedures

(a) *Disclosure controls and procedures.* Our management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934. As of December 31, 2014, an evaluation was performed under the supervision and with the participation of our management of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures as of December 31, 2014 were effective.

(b) *Internal controls over financial reporting.* Our management is responsible for establishing and maintaining adequate control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2014. In making this assessment, our management used the criteria established in *Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (1992)*. Based on that evaluation, our management believes our internal control over financial reporting was effective as of December 31, 2014.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective may not prevent or detect misstatements and can provide only reasonable assurances with respect to the preparation and presentation of financial statements.

(c) *Internal controls.* There have been no significant changes in our internal control over financial reporting that occurred during the fiscal year ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **Item 16. Reserved**

### **Item 16A. Audit Committee Financial Expert**

Our Board of Directors has determined that Jaron Diament, chairperson of our audit committee, is an audit committee financial expert, as defined by applicable SEC regulations, and is independent in accordance with applicable SEC regulations.

### **Item 16B. Code of Ethics**

We have adopted a Code of Conduct applicable to all employees, directors and officers of our company, including our principal executive officer, principal financial officer, principal accounting officer or controller and other individuals performing similar functions. A copy of our Code of Conduct can be found on our website (<http://www.xtlbio.com>) and may also be obtained, without charge, upon a written request addressed to our investor relations department, XTL Biopharmaceuticals Ltd., 5 HaCharoshet Street, Raanana 43656, Israel.

### **Item 16C. Principal Accountant Fees and Services**

#### **Policy on Pre-Approval of Audit and Non-Audit Services of Independent Registered Public Accounting Firm**

Our audit committee is responsible for the oversight of the independent registered public accounting firm's work. The audit committee's policy is to pre-approve all audit and non-audit services provided by our independent registered public accounting firm, Kesselman & Kesselman, a member firm of PricewaterhouseCoopers International Ltd. ("PwC"). These services may include audit services, audit-related services and tax services, as further described below.

**Principal Accountant Fees and Services**

We were billed the following fees for professional services rendered by PwC, for the years ended December 31, 2014 and 2013.

	2014	2013
	US dollars in thousands	
Audit fees	52	52
Audit-related fees	-	4
Tax fees	-	-
All Other fees	-	-
Total	52	56

The audit fees for the years ended December 31, 2014 and 2013, respectively, were for professional services rendered for the audit of our annual consolidated financial statements, review of interim consolidated financial statements and statutory audits, including Israeli tax reports.

The audit-related fees for the year ended December 31, 2013 were for the professional services rendered for obtaining SEC approval for the incorporation of Proteologics' quarterly financial statements in the 2013 Form 20-F.

The audit-related fees above do not include InterCure's audit-related fees for the years ended December 31, 2014 and 2013 in the amounts of \$ 28 thousand and \$ 40 thousand, respectively.

For the fiscal years ended December 31, 2014 and 2013, all of our audit-related fees, tax fees and other fees were pre-approved by our audit committee.

**Item 16D. Exemptions from the Listing Standards for Audit Committees**

Not applicable.

**Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

Not applicable.

**ITEM 16F. cHANGE IN REGISTRANT'S REGISTERED ACCOUNTANT**

Not applicable.

**ITEM 16G. CORPORATE GOVERNANCE**

Under the Nasdaq corporate governance rules, foreign private issuers are exempt from many of the requirements if they instead elect to comply with home country practices and disclose where they have elected to do so. As noted above, we are currently in compliance with Nasdaq rules relating to the independence of our board of directors and our audit committee. Our board of directors and our audit have adopted a written charter for the audit committee setting forth the responsibilities of the audit committee as required by the SEC and Nasdaq. Also as noted above, we currently have a nomination committee to identify, review and recommend to the Board of Directors individuals believed to be qualified to become directors. We have adopted a written charter for the nomination committee, as required by Nasdaq. We currently have in place a compensation committee, as discussed in more detail above. We have adopted a written charter for the compensation committee.

In August 2005, our board of directors adopted a Code of Conduct that applies to all employees, directors and officers of our company, including our principal executive officer, principal financial officer, principal accounting officer or controller and other individuals performing similar functions. A copy of our Code of Conduct may be obtained, without charge, upon a written request addressed to our investor relations department, XTL Biopharmaceuticals Ltd., 5 HaCharoshet Street, Raanana 43656, Israel.



PART III

**Item 17. Financial Statements**

We have elected to furnish financial statements and related information specified in Item 18.

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**Item 18. Financial Statements**

**XTL BIOPHARMACEUTICALS LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2014**

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**Report of Independent Registered Public Accounting Firm**

**XTL BIOPHARMACEUTICALS LTD.**

We have audited the consolidated Statements of Financial Position of XTL Biopharmaceuticals Ltd. (hereafter – the “Company”) and its subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of comprehensive loss, changes in equity and cash flows for each of the three years in the period ended December 31, 2014. 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 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 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, 2014 and 2013, and the consolidated comprehensive loss, changes in equity and cash flows for each of the three years ended December 31, 2014, in conformity with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

Tel-Aviv, Israel                      Kesselman & Kesselman  
April 26, 2015      Certified Public Accountants (Isr.)  
A member firm of PricewaterhouseCoopers International Limited

**XTL BIOPHARMACEUTICALS LTD.****CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

		December 31,	
		2014	2013
	Note	U.S. dollars in thousands	
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	6	2,159	2,887
Short-term deposits	7	-	1,278
Trade receivables	8	-	126
Other accounts receivable	9	437	473
Restricted deposits		21	23
Inventories	10	-	302
		2,617	5,089
Assets of disposal group classified as held for sale	28	505	-
		3,122	5,089
<b>NON-CURRENT ASSETS:</b>			
Property, plant and equipment, net	13	24	61
Intangible assets, net	14	2,498	2,865
		2,522	2,926
Total assets		5,644	8,015

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

**XTL BIOPHARMACEUTICALS LTD.****CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

	Note	December 31, 2014	2013
		U.S. dollars in thousands	
<b>LIABILITIES AND EQUITY</b>			
<b>CURRENT LIABILITIES:</b>			
Trade payables	15	217	615
Other accounts payable	16	298	604
		515	1,219
Liabilities of disposal group classified as held for sale	28	450	-
		965	1,219
<b>NON-CURRENT LIABILITIES:</b>			
Employee benefit liabilities		-	11
<b>EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY:</b>			
Share capital – ordinary shares of NIS 0.1 par value: authorized – December 31, 2013 and 2014 – 700,000,000 shares; issued and outstanding:	19		
December 31, 2014 – **232,812,446		6,198	6,093
December 31, 2013 – **226,826,957			
Share premium and options		148,276	148,327
Accumulated deficit		(148,322)	(146,073)
Treasury shares, at cost:			
December 31, 2013 – 6,067,943		(1,501 )	(2,091 )
December 31, 2014 – 4,354,881			
Reserve from transactions with non-controlling interests		9	9
		4,660	6,265
Non-controlling interests		19	520
Total equity		4,679	6,785
Total liabilities and equity		5,644	8,015

\*\* Net of treasury shares

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

David Bassa	Josh Levine	David Kestenbaum
Chairman of the Board	Chief Executive Officer	Chief Financial Officer

Date of approval of the financial statements by the Company's Board: April 26, 2015.

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**XTL BIOPHARMACEUTICALS LTD.**

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

		Year ended December 31,		
		2014	2013	2012
	Note	U.S. dollars in thousands (except per share data)		
Continuing operations:				
Research and development expenses	21	(278 )	(82 )	(92 )
General and administrative expenses	22	(1,744 )	(1,329 )	(2,448 )
Other gains, net	23	-	1,059	802
Operating loss		(2,022 )	(352 )	(1,738 )
Finance income	24	41	114	55
Finance expenses	24	(138 )	(55 )	(5 )
Finance income (expenses), net		(97 )	59	50
Earnings (loss) from investment in associate	12	-	(845 )	569
Loss from continuing operations		(2,119 )	(1,138 )	(1,119 )
Loss from discontinued operations	28	(746 )	(2,575 )	(623 )
Total loss for the year		(2,865 )	(3,713 )	(1,742 )
Other comprehensive income (loss):				
Items that might be classified to profit or loss:				
Foreign currency translation adjustments		-	108	114
Reclassification of foreign currency translation adjustments to Other gains, net		-	(221 )	-
Total other comprehensive income (loss)		-	(113 )	114
Total comprehensive loss		(2,865 )	(3,826 )	(1,628 )
Total loss attributable to:				
Equity holders of the Company		(2,527 )	(2,476 )	(1,390 )
Non-controlling interests		(338 )	(1,237 )	(352 )
		(2,865 )	(3,713 )	(1,742 )
Total comprehensive loss attributable to:				

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Equity holders of the Company		(2,527)	(2,589)	(1,276)
Non-controlling interests		(338 )	(1,237)	(352 )
		(2,865)	(3,826)	(1,628)
Basic and diluted loss per share from continuing and discontinued operations (in U.S. dollars):	26			
From continuing operations		(0.009)	(0.005)	(0.005)
From discontinued operations		(0.002)	(0.006)	(0.001)
Loss per share for the period		(0.011)	(0.011)	(0.006)

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



**XTL BIOPHARMACEUTICALS LTD.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

	Attributable to equity holders of the Company						Non-controlling interests	Total equity
	Share capital	Premium on shares, options and warrants	Accumulated deficit	Treasury shares	Reserve from transactions with non-controlling interests	Total		
	U.S. dollars in thousands							
Balance as of January 1, 2014	6,093	148,327	(146,073 )	(2,091 )	9	6,265	520	6,785
Total comprehensive loss	-	-	(2,527 )	-	-	(2,527)	(338 )	(2,865)
Share-based payment to employees and others	-	-	278	-	-	278	-	278
Issuance of shares	14	158	-	-	-	172	-	172
Sale of treasury shares	-	(197 )	-	590	-	393	(163 )	230
Exercise of options into shares	91	(12 )	-	-	-	79	-	79
Balance as of December 31, 2014	6,198	148,276	(148,322 )	(1,501 )	9	4,660	19	4,679

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

**XTL BIOPHARMACEUTICALS LTD.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

	Attributable to equity holders of the Company					Foreign currency translation adjustment of foreign operations	Reserve from transactions with non- controlling interests	Total	Non- controlling interests	Total equity
	Share capital	Share premium and options	Accumulated deficit	Treasury shares						
	U.S. dollars in thousands									
Balance as of January 1, 2013	5,997	147,475	(143,560 )	(2,469 )	114	(204 )	7,353	2,071	9,424	
Loss for the year	-	-	(2,476 )	-	-	-	(2,476)	(1,237 )	(3,713)	
Other comprehensive income	-	-	-	-	(113 )	-	(113 )	-	(113 )	
Total comprehensive loss	-	-	(2,476 )	-	(113 )	-	(2,589)	(1,237 )	(3,826)	
Share-based payment to employees and others	-	-	(7 )	-	-	-	(7 )	(58 )	(65 )	
Issuance of shares and warrants	90	876	-	-	-	-	966	-	966	
Exercise of options in associate	-	-	-	-	(1 )	-	(1 )	-	(1 )	
Sale of treasury shares	-	(52 )	-	378	-	-	326	(43 )	283	
Conversion of convertible loan into capital, in subsidiary	-	-	-	-	-	213	213	(213 )	-	
Other	-	-	(30 )	-	-	-	(30 )	-	(30 )	
Exercise of warrants into shares	6	28	-	-	-	-	34	-	34	
Balance as of December 31, 2013	6,093	148,327	(146,073 )	(2,091 )	-	9	6,265	520	6,785	

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

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**XTL BIOPHARMACEUTICALS LTD.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

	Attributable to equity holders of the Company								
	Share capital	Share premium and options	Accumulated deficit	Treasury shares	Foreign currency translation adjustments of foreign operations	Reserve from transactions with non-controlling interests	Total	Non-controlling interests	Total equity
U.S. dollars in thousands									
Balance as of January 1, 2012	5,335	141,385	(143,276 )	-	-	-	3,444	-	3,444
Loss for the year	-	-	(1,390 )	-	-	-	(1,390)	(352 )	(1,742)
Other comprehensive income	-	-	-	-	114	-	114	-	114
Total comprehensive loss	-	-	(1,390 )	-	114	-	(1,276)	(352 )	(1,628)
Share-based payment to employees and others	-	-	1,106	-	-	-	1,106	193	1,299
Issuance of shares for business combination	176	2,293	-	(2,469 )	-	-	-	1,858	1,858
Issuance of shares and options	309	2,109	-	-	-	-	2,418	-	2,418
Conversion of convertible loan into capital in subsidiary	-	-	-	-	-	(204 )	(204 )	372	168
Exercise of warrants into shares	177	1,688	-	-	-	-	1,865	-	1,865
Balance as of December 31, 2012	5,997	147,475	(143,560 )	(2,469 )	114	(204 )	7,353	2,071	9,424

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



**XTL BIOPHARMACEUTICALS LTD.**

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2014	2013	2012
	Note U.S. dollars in thousands		
Cash flows from operating activities:			
Loss for the year	(2,865)	(3,713)	(1,742)
Adjustments to reconcile loss to net cash used in operating activities (a)	395	1,214	236
Net cash used in operating activities	(2,470)	(2,499)	(1,506)
Cash flows from investing activities:			
Acquisition of subsidiary, less cash received (d)	5	-	733
Investment in associate	-	-	(1,658)
Proceeds from sale of investment in associate	291	3,054	-
Decrease in restricted deposit	2	-	1
Decrease (increase) in short-term bank deposits	1,216	366	(170)
Purchase of property, plant and equipment	13	(8)	(6)
Purchase of intangible assets	14	(2)	(80)
Other investments	-	-	(29)
Net cash provided by (used) in investing activities	1,499	3,336	(1,209)
Cash flows from financing activities:			
Proceeds from issuance of shares and options	19	79	2,418
Exercise of warrants and options into shares	19	-	1,865
Sale of treasury shares		230	283
Net cash provided by financing activities	309	317	4,283
Increase (decrease) in cash and cash equivalents	(662)	1,154	1,568
Gains (losses) from exchange rate differences on cash and cash equivalents	(14)	37	5
Reclassification of cash in subsidiary to assets of disposal group held for sale	(52)	-	-
Cash and cash equivalents at beginning of year	2,887	1,696	123
Cash and cash equivalents at end of year	2,159	2,887	1,696

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

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**XTL BIOPHARMACEUTICALS LTD.****CONSOLIDATED STATEMENT OF CASH FLOWS**

Year ended December 31,  
2014 2013 2012  
Note U.S. dollars in thousands

(a) Adjustments to reconcile loss to net cash provided by (used in) operating activities:

Income and expenses not involving cash flows:

Depreciation and amortization	13, 14	53	313	136
Loss from disposal of property, plant and equipment	13, 14	142	2	2
Share-based payment transactions to employees and others	20	278	(65 )	1,299
Revaluation of short-term deposits		62	(29 )	(75 )
Exchange rate differences on operating activities		14	(37 )	(5 )
Gain from bargain purchase	5	-	-	(795 )
Change in employee benefit liabilities, net		12	(2 )	2
Loss (gain) from change in holding rate in associate	12	-	(10 )	5
Earnings from investment in associate	12	-	845	(569 )
Impairment of intangible assets	14	-	1,729	-
Gain from sale of investment in associate		-	(1,051 )	-

561 1,695 -

Changes in operating asset and liability items:

Decrease (increase) in trade receivables	8	58	(50 )	3
Decrease (increase) in other accounts receivable and income taxes receivable	9	(130 )	30	(23 )
Increase in inventories	10	184	(73 )	(44 )
Increase (decrease) in trade payables	15	(210 )	(86 )	199
Increase (decrease) in other accounts payable	16	(68 )	(302 )	101

(166 ) (481 ) 236

395 1,214 236

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





**XTL BIOPHARMACEUTICALS LTD.**

## CONSOLIDATED STATEMENT OF CASH FLOWS

	Year ended December 31,		
	2014	2013	2012
	U.S. dollars in thousands		
(b) Additional information on cash flows from operating activities:			
Interest received	9	24	40
(c) Non-cash transactions:			
Purchase of property, plant and equipment on suppliers' credit	-	-	73
Issuance of treasury shares to subsidiary	-	-	2,469
Conversion of convertible loan into capital in subsidiary	-	377	168
Share-based payment to third party	173	49	-
Allotment of shares to Aurum	-	913	-
Receivables from sale of investment in associate	-	297	-
(d) Acquisition of newly consolidated subsidiary (see Note 5):			
Working capital (excluding cash and cash equivalents)	-	-	517
Property, plant and equipment	-	-	(51 )
Intangible assets	-	-	(2,397 )
Gain from bargain purchase	-	-	795
Non-current liabilities	-	-	11
Non-controlling interests	-	-	1,858
	-	-	733

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

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

NOTE 1:- GENERAL

a. A general description of the Company and its activity:

XTL Biopharmaceuticals Ltd. (the “**Company**”) is engaged in the development of therapeutics for the treatment of unmet medical needs. The Company was incorporated under the Israeli Companies Law on March 9, 1993. The registered office of the Company is located at 85 Medinat Hayehudim Street, Herzliya 46766.

The Company’s American Depository Shares (“**ADSs**”) are listed for trading on the Nasdaq Capital Market and its ordinary shares are traded on the Tel-Aviv Stock Exchange (“**TASE**”).

On July 25, 2012, the Company completed the acquisition of approximately 50.79% of the issued and outstanding share capital of InterCure Ltd., a public company whose shares are traded on the TASE. As of December 31, 2014, the Company held approximately 54.72% of InterCure’s issued and outstanding share capital. For additional information on the Company’s investment in InterCure, as well as events pertaining to sale of the investment, see Notes 5 and 30 below.

On January 7, 2014, the Company signed a licensing agreement with Yeda to develop hCDR1, a Phase II-ready asset for the treatment of Systemic Lupus Erythematosus (“**SLE**”). The terms of the licensing agreement include, among other things, expense reimbursement for patent expenses, certain milestone payments to Yeda, low single-digit royalties based on net sales, and additional customary royalties to the Office of the Chief Scientist.

The Company is in the planning stages for the implementation of a phase 2 clinical trial of the recombinant EPO (“**rHuEPO**”) drug for treating Multiple Myeloma patients. As part of the preparations, the Company has conducted a study which consists of collecting preliminary data on the existence of specific proteins in the blood of a group of Multiple Myeloma patients and is preparing market analyses and regulatory activities. The data collected in the preliminary study will be combined in the plans and preparations for the implementation of the phase 2 clinical trial, as needed. Based on the Company’s current business plans and estimates, the clinical trial is expected to commence during the second half of 2015.

As of December 31, 2014, the Company has the following subsidiaries:

InterCure – a publicly traded company on the TASE. InterCure has two subsidiaries – InterCure Inc., incorporated in the U.S., and InterCure UK (inactive), incorporated in the UK.

Xtepo Ltd. – a private company incorporated in Israel which holds a license for the exclusive use of the patent for rHuEPO drug for treating Multiple Myeloma patients.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

NOTE 1:- GENERAL (Cont.)

The Company has incurred continuing losses and depends on outside financing resources to continue its activities. Based on existing business plans, the Company's management estimates that its outstanding cash and cash equivalent balances, including short-term deposits, will allow the Company to finance its activities for an additional period of at least 12 months from the date of this report. However, the amount of cash which the Company will need in practice to finance its activities depends on numerous factors which include, but are not limited to, the timing, planning and execution of clinical trials of existing drugs and future projects which the Company might acquire or other business development activities such as acquiring new technologies and/or changes in circumstances which are liable to cause significant expenses to the Company in excess of management's current and known expectations as of the date of these financial statements and which will require the Company to reallocate funds against plans, also due to circumstances beyond its control.

The Company expects to incur additional losses in 2015 arising from research and development activities, testing additional technologies and operating activities, which will be reflected in negative cash flows from operating activities. In order to perform the clinical trials aimed at developing a product until obtaining its marketing approval, the Company may be required to raise additional funds in the future by issuing securities. Should the Company fail to raise additional capital in the future under standard terms, it will be required to minimize its activities or sell or grant a sublicense to third parties to use all or part of its technologies.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. Basis of presentation of the financial statements:

The consolidated financial statements of the Company (the "**Financial Statements**") have been prepared in accordance with International Financial Reporting Standards (IFRSs), as issued by the International Accounting Standards Board (IASB).

The consolidated financial statements have been consistently applied to all the years presented, unless otherwise stated and have been prepared under the historical cost convention, as adjusted for defined benefit plans.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires the Group's management to exercise its judgment in the process of applying the Group's

accounting policies. The areas that involve judgment which have significant effect or complexity or where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3. Actual results could significantly differ from the estimates and assumptions used by the Group's management.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b.Consolidated financial statements:

1.Subsidiaries consolidation and business combinations:

The consolidated financial statements include the accounts of the Company and entities controlled by the Company. Control exists when the Company has the power over the investee; has exposure, or rights, to variable returns from involvement in the investee; and has the ability to use its power over the investee to affect its returns.

The Company examines whether it controls another entity even when it does not hold more than 50% of the voting rights, but can control the entity's financial and operating policies by de-facto control. De-facto control can be created under circumstances in which the ratio of the Company's voting rights in the entity to the percentage and dispersion of the holdings of the other shareholders grants the Company the power to control the entity's financial and operating policies.

Subsidiaries are fully consolidated starting from the date on which control therein is attained by the Company. Their consolidation ceases when such control is discontinued.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Intra-group balances and transactions, including revenues, expenses and dividends in respect of transactions between the Group companies, are eliminated. Gains and losses arising from intra-group transactions that have been recognized as assets (such as inventories and property, plant and equipment) are also eliminated. Such intra-group losses may point to the impairment of assets which is tested and accounted for as specified in g below.

2. Transactions with non-controlling interests which do not result in loss of control:

Transactions with non-controlling interests in subsidiaries which do not result in loss of control in the subsidiaries are accounted for as transactions with owners. In these transactions, the difference between the fair value of any consideration paid or received and the amount of adjustment of the non-controlling interests to reflect the changes in their relative rights in the subsidiaries is directly recognized in equity and attributed to the equity holders of the parent.

3. Associate:

An associate is an entity over which the Group exercises significant influence, but not control, which is usually expressed in holding 20%-50% of the voting rights. The investment in an associate is presented using the equity method of accounting. According to the equity method of accounting, the investment is initially recognized at cost and its carrying amount varies to the extent that the Group recognizes its share of the associate's earnings or losses from the acquisition date.

The Group's share in the earnings or losses of associates after the acquisition date is carried to profit or loss and its share in the other comprehensive income movements after the acquisition date is carried to other comprehensive income against the carrying amount of the investment.



**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Each reporting date, the Group determines if there are indicators of impairment in the investment in the associate. In such case, the Group calculates the amount of the impairment as the difference between the recoverable amount of the investment in the associate (the higher of the value in use and the fair value less selling costs) and its carrying amount and recognizes the amount of impairment in profit or loss in the line item of “equity in earnings (losses) in associates”.

c. Translation of balances and transactions in foreign currency:

1. Functional currency and presentation currency:

Items included in the financial statements of each of the Group’s entities are measured using the currency of the primary economic environment in which the entity operates (the “**Functional Currency**”). The consolidated financial statements are presented in U.S. dollars, which is the Functional Currency of each of the Group’s entities and the Company’s presentation currency.

Below are the changes in the reporting periods in the exchange rate of the U.S. dollar in relation to the NIS:

Year ended	Change in the exchange rate of U.S. \$ 1 %
December 31, 2014	12.04
December 31, 2013	(7.02 )
December 31, 2012	(2.30 )

As of	Exchange rate of U.S. \$ 1 NIS
December 31, 2014	3.889
December 31, 2013	3.471

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

2. Transactions and balances:

Transactions in a currency other than the Functional Currency (“**foreign currency**”) are translated into the Functional Currency using the exchange rates at the dates of the transactions. After initial recognition, monetary assets and liabilities denominated in foreign currency are translated at the end of each reporting period into the Functional Currency at the exchange rate at that date. Exchange differences are recognized in the statement of comprehensive income in the line item finance income (expenses). Non-monetary assets and liabilities denominated in foreign currency and measured at cost are translated at the exchange rate at the date of the transaction.

3. Translation of the financial statements of the Group companies:

The operating results and financial position of all the Group companies, including companies accounted for at equity, whose functional currency differs from the presentation currency (Proteologics’ functional currency is NIS), are translated into the presentation currency as follows:

a) Assets and liabilities at each statement of financial position date are translated at the closing rate on the statement of financial position date;

b) Revenues and expenses at each statement of comprehensive income date are translated at the average exchange rates for the period (unless this average is not a reasonable approximation of the cumulative effect of exchange rates on the transaction dates in which case the revenues and expenses are translated at the exchange rate on the transaction date);

c) All resulting exchange rate differences are recognized in other comprehensive income.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

d. Property, plant and equipment:

Items of property, plant and equipment are measured at cost with the addition of direct acquisition costs, less accumulated depreciation and accumulated impairment losses.

Depreciation of property, plant and equipment is calculated on a straight-line basis to reduce their cost to their residual value over their useful life as follows:

	%
Computers	33
Office furniture and equipment	6 - 15
Production molds	20

The useful life, depreciation method and residual value of an asset are reviewed at least each year-end and any changes are accounted for prospectively as a change in accounting estimate.

Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognized. An asset is derecognized on disposal or when no further economic benefits are expected from its use. The gain or loss arising from derecognition of the asset (determined as the difference between the net disposal proceeds and the carrying amount in the financial statements) is included when the asset is derecognized in “other gains (losses), net” in the consolidated statements of comprehensive income.

An asset’s carrying amount is written down immediately to its recoverable amount if the asset’s carrying amount is greater than its estimated recoverable amount (see g below).

e. Intangible assets:

5. Brand name and technology:

Brand name and technology acquired in a business combination are recognized at fair value on the acquisition date. Brand name and technology have a finite useful life and are presented at cost net of accumulated amortization and impairment losses. The amortization is calculated using the straight-line method over the expected useful life (9-10 years).

6. Computer software:

Acquired licenses to use computer software are capitalized based on costs incurred in acquiring the specific software and preparing it for use. These costs are amortized using the straight-line method over the estimated useful life (five years). Costs relating to computer software upkeep are recognized as expenses as incurred.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

7. Unamortized intangible assets (licenses and patent rights):

The amortization of an asset on a straight-line basis over its useful life begins when the development procedure is completed and the asset is available for use. These assets are reviewed for impairment once a year or whenever there are indicators of a possible impairment, in accordance with the provisions of IAS 36, *Impairment of Assets*.

8. Research and development:

Research expenditures are recognized as expenses when incurred. Costs arising from development projects are recognized as intangible assets when the following criteria are met:

- it is technically feasible to complete the intangible asset so that it will be available for use;
- management intends to complete the intangible asset and use or sell it;
- there is an ability to use or sell the intangible asset;
- it can be demonstrated how the intangible asset will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the intangible asset are available; and
- the expenditure attributable to the intangible asset during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognized as an expense when incurred. Development costs that were previously recognized as an expense are not recognized as an asset in a later period. During the three years ended December 31, 2014, the Group did not capitalize development costs to intangible assets.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

f. Impairment of non-financial assets:

Intangible assets which are not yet available for use are not depreciated and impairment in their respect is tested every year. Depreciable 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. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that sustained impairment are reviewed for possible reversal of the impairment at each date of the statement of financial position.

g. Financial assets:

1. Classification:

The Group classifies its financial assets into the loans and receivables category. The classification depends on the purpose for which the financial assets were acquired. The Group's management determines the classification of its financial assets at initial recognition.

*Loans and receivables:*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the date of the statement of financial position. The Group's loans and receivables are included in the line items: "trade receivables", "other accounts receivable", "cash and cash equivalents", "short-term deposits" and "restricted deposits" in the statement of financial position.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

2. Recognition and measurement:

Regular purchases and sales of financial assets are recognized in the books of the Group companies on the transaction settlement date which is the date on which the asset is transferred to the Group or transferred by the Group. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Loans and receivables are subsequently carried at amortized cost using the effective interest method.

3. Impairment of financial assets:

*Financial assets carried at amortized cost:*

The Group assesses at the date of each statement of financial position whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

h. Inventories:

Inventories are measured at the lower of cost and net realizable value. The cost of inventories comprises costs of purchase and costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated selling costs. The Group periodically evaluates the condition and age of inventories and makes provisions for slow moving inventories accordingly.

Cost of inventories is determined as follows:



Raw materials – at cost of purchase using the “first-in, first-out” method.

Purchased merchandise and products – using the “first-in, first-out” method.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

i. Trade receivables:

The balance of trade receivables relates to amounts receivable from the Group's customers for goods sold or services rendered in the ordinary course of business. Trade receivables are initially recognized at fair value and subsequently measured at amortized cost based on the effective interest method, less an allowance for doubtful accounts.

Allowance for doubtful accounts:

The allowance for doubtful accounts is determined in respect of specific debts whose collection, in the opinion of the Group's management, is doubtful. The Group also recognizes a provision for groups of customers that are collectively assessed for impairment based on their credit risk characteristics. Impaired debts are derecognized when they are assessed as uncollectible.

j. Cash and cash equivalents:

Cash and cash equivalents include cash at hand and short-term bank deposits with original maturities of three months or less, that are not restricted as to withdrawal or use, and are therefore considered to be cash equivalents.

k. Share capital:

The Company's ordinary shares are classified as share capital. Incremental costs directly attributable to the issuance of new shares or options are shown in equity as a deduction, net of tax, from the issuance proceeds.

When Group companies purchase Company shares (treasury shares), the consideration paid, including incremental costs directly attributable to the purchase (less the effect of taxes on income), is deducted from the equity attributable to equity holders of the parent until the shares are eliminated or reissued. When these shares are reissued in subsequent periods, the consideration received, less incremental costs directly attributable to the transaction and less

the effect of taxes on income, is included in equity attributable to equity holders of the parent.

1. Trade payables:

Trade payables are the Group's obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are initially recognized at fair value and subsequently measured at amortized cost using the effective interest method.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

m. Taxes on income:

1. Current taxes:

The current tax liability is measured using the tax rates and tax laws that have been enacted or substantively enacted by the reporting date as well as adjustments required in connection with the tax liability in respect of prior years.

2. Deferred taxes:

Deferred taxes are computed in respect of temporary differences between the carrying amounts in the financial statements and the amounts attributed for tax purposes.

A deferred tax asset has not been recognized in the Group's accounts because the availability of taxable income in the future is not probable.

n. Employee benefits:

1. Employment benefits for retirement compensation/pension:

The Group operates various pension plans. The plans are generally funded through payments to insurance companies or trustee-administered funds. Said pension plans qualify for the criteria of defined contribution plan, as above, based on their terms.

According to the labor laws and employment agreements in Israel and according to the Group's practice, the Group is obligated to pay compensation to employees who are dismissed and, under certain circumstances, to employees who retire. The Group's liability to pay retirement compensation for certain employees is accounted for as a defined benefit plan and for the remaining employees it is accounted for as a defined contribution plan.

2. Vacation and recreation benefits:

According to the Law, an employee is entitled to paid annual leave and sick leave on an annual basis. The entitlement is based on the number of years of service. The Company recognizes an obligation and expense for paid annual leave and sick leave based on the benefit accumulated for each employee.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

o. Share-based payment:

The Group operates a number of share-based payment plans to employees and to other service providers who render services that are similar to employees' services that are settled with the Group's equity instruments. In this framework, the Group grants employees, from time to time, and, at its discretion, options to purchase shares of the Group companies. The fair value of services received from employees in consideration of the grant of options is recognized as an expense in the statement of comprehensive income (loss) and correspondingly carried to equity. The total amount recognized as an expense over the vesting term of the options (the term over which all pre-established vesting conditions are expected to be satisfied) is determined by reference to the fair value of the options granted at grant date, except the effect of any non-market vesting conditions.

Non-market vesting conditions are included in the assumptions used in estimating the number of options that are expected to vest. The total expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions of the share-based payment arrangement are to be satisfied.

In each reporting date, the Company revises its estimates of the number of options that are expected to vest based on the non-market vesting conditions and recognizes the impact of the revision to original estimates, if any, in the statement of comprehensive income (loss) with a corresponding adjustment in equity.

When the options are exercised, the Company issues new shares. The proceeds net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium.

Share-based payment transactions in which the Company acquired assets as consideration for the Company's equity instruments are measured at the value of the assets acquired.

p.

Provisions:

A provision in accordance to IAS 37 is recognized when the Group has a present obligation (legal or constructive) as a result of event occurred in the past, probable to be required to use economic resources to settle the obligation and can be reliably estimated. The group recognizes a provision for warranty when the product is sold to the customer or when the service is provided to the customer. Initial recognition is based on past experience. The estimated provision is re-tested every year.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

q. Revenue recognition:

Revenues are recognized in profit or loss when the revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Revenues are measured at the fair value of the consideration received less any trade discounts, volume rebates and returns.

Following are the specific revenue recognition criteria which must be met before revenue is recognized:

*Revenues from sale of goods to retail customers:*

Revenues from the sale of goods are recognized when all the significant risks and rewards of ownership of the goods have passed to the buyer and the seller no longer retains continuing managerial involvement. The delivery date to the customer is usually the date on which ownership passes.

*Revenues from sale of goods to distributors:*

InterCure sells its products to distributors as well. Revenues from such sales are recognized when InterCure or its subsidiaries deliver the goods to the distributor, when sales channel and selling price are at the distributor's sole discretion, and when there are no ongoing obligations to prevent the distributor from receiving the goods. Revenue is only recognized when goods were delivered to the designated site, risks of loss and damage are transferred to the distributor and distributor had received the goods in accordance with the sales agreement, conditions for receipt of goods had expired or InterCure holds objective evidence that goods receipt criteria had been met.

Sales do not include a finance component, as they are made with a 60 days credit period, considered as consistent with the market in which InterCure operates.



r.

Leases:

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the statement of comprehensive income (loss) on a straight-line basis over the period of the lease.

s.

Loss per share:

Basic loss per share is calculated by dividing the income or loss attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the period, less Company shares held by a subsidiary.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

In calculating diluted loss per share, in addition to the average of ordinary shares used for calculating basic loss, the weighted average number of shares that will be issued assuming that all the potentially dilutive shares are converted into shares is also taken into consideration. Potential shares are taken into account as above only when their effect is dilutive (reduces the earnings or increases the loss per share).

t. Non-current assets (or disposal groups) held for sale:

Non-current assets (or disposal groups) are classified as held for sale when their carrying amount will be recovered principally through a sale transaction rather than through continuing use.

u. Discontinued operations:

A discontinued operation is a component of an entity that either has been disposed of, or is classified as held for sale, and represents a separate major line of business or geographical area of operations, or is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale.

Revenues and expenses attributable to discontinued operations are presented in the statement of comprehensive loss under the item "*Total loss from discontinued operations*", for all years presented.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 3:- CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a. Critical accounting estimates and assumptions:

Accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

1. Intangible assets

(i) In testing impairment of research and development assets, the Company's management is required to estimate, among other things, the probable endpoints of trials conducted by the Company, the commercial technical feasibility of the development and the resulting economic benefits. Actual results and estimates to be made in the future may significantly differ from current estimates.

(ii) The Group is required to determine at the end of each reporting period whether there is any indication that an asset may be impaired. If indicators for impairment are identified, the Group estimates the assets' recoverable amount, which is the higher of an asset's fair value less costs to sell and its value-in-use. The value-in-use calculations require management to make estimates of the projected future cash flows. Determining the estimates of the future cash flows is based on management past experience and best estimate for the economic conditions that will exist over the remaining useful economic life of the CGU.

2. Share-based payments – in evaluating the fair value and the recognition method of share-based payment, the Company's management is required to estimate, among others, different parameters included in the computation of the fair value of the options and the Company's results and the number of options that will vest.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 3:- CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Cont.)**

3. The existence of effective control over InterCure:

As of December 31, 2014, and effective as of May 16, 2013, the Company held 54.72% of InterCure's issued and outstanding share capital, following the conversion of the loan granted to InterCure into 7,620,695 shares of InterCure. In the reporting period ended December 31, 2012, the Group's management had estimated the degree of effect it had in InterCure and had determined that it was able to govern InterCure's financial and operating policies despite holding less than 50% of InterCure's issued and outstanding share capital at the time, through de-facto control, this following an examination of InterCure's entire equity instruments. This conclusion was reached mainly since the Company was able to convert the aforementioned loan into shares of InterCure, a conversion which will have conferred the Company a stake of approximately 54.72% of InterCure's issued and outstanding share capital.

After the reporting period, events pertaining to the investment in InterCure reduced the Company's stake in InterCure to 5.82%. Considering the Company's diluted voting rights in InterCure and the termination of a voting agreement signed between the Company and Green Forest Global Ltd., under which each of the two parties will appoint two directors of the total of seven directors to the board of directors of InterCure, the Company's management determined that a loss of control in InterCure occurred during the first quarter of 2015. For additional information, see Notes 5 and 30 below.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 4:- FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT**

a. Financial risk management:

1. Financial risk factors:

The Group's activities expose it to a variety of financial risks: market risks (including currency risks and price risk), credit risk and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

Risk management is carried out by the Group's management under policies approved by the Board. The Group's treasury identifies, evaluates and defines financial risks. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk and investment of excess liquidity.

a) Market risks:

*Foreign currency exchange rate risk:*

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the NIS. Foreign exchange risk arises from assets and liabilities denominated in currency that is other than the functional currency.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 4:- FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (Cont.)**

To manage its foreign exchange risk arising from future commercial transactions and recognized assets and liabilities, the Group uses short-term deposits denominated in foreign currency.

The Company treasury's risk management policy, excluding InterCure, is to hold NIS-denominated cash and cash equivalents and short-term deposits in the amount of the anticipated NIS-denominated liabilities for nine to twelve consecutive months from time to time and this in line with the directives of the Company's Board. InterCure focuses on actions to reduce to a minimum the negative effects arising from this risk and therefore holds cash and cash equivalents in currencies in which it operates, in accordance with management's assessments.

As of December 31, 2014, had the Group's functional currency weakened by 10% against the NIS with all other variables remaining constant, post-tax loss for the year would have been \$ 85 thousand lower (2013 – loss approximately \$ 157 thousand lower; 2012 – loss approximately \$ 89 thousand lower), mainly as a result of exchange rate changes on translation of other accounts receivable, net and exchange rate changes on NIS-denominated cash and cash equivalents and short-term deposits.

b)

Credit risks:

Credit risks are managed at the Group level. The Group has no significant concentrations of credit risk. Credit risks arise from cash and cash equivalents, restricted bank deposits as well as outstanding receivables.

The majority of the Group's sales are generated in the U.S. Accordingly, the balances of the Group's trade receivables do not represent a significant concentration of credit risk as of December 31, 2014. InterCure extends a 60-day term to its customers. InterCure regularly monitors the credit extended to its customers and their general financial condition but does not require collateral as security for these receivables. InterCure provides an allowance for doubtful accounts based on the factors that affect the credit risk of certain customers, past experience and other information.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 4: FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (Cont.)**

The Group engages with banks and financial institutions which are independently rated A at least.

c) Liquidity risk:

Cash flow forecasting is performed by the Group's management both in the entities of the Group and aggregated by the Group. The Group's management monitors rolling forecasts of the Group's liquidity requirements to ensure it has sufficient cash to meet operations. The Group does not use borrowing credit facilities.

Surplus cash held to finance operating activities is invested in interest bearing current accounts, time deposits and other solid channels. These channels were chosen by reference to their appropriate maturities or liquidity to provide sufficient cash balances to the Group as determined by the abovementioned forecasts.

As of December 31, 2014 and 2013, the maturity of the Group's financial liabilities is less than one year from each of the reporting dates.

2. Capital management:

The Group's objectives when managing capital are to ensure the Group's ability to continue as a going concern in order to provide returns on investments for shareholders and benefits for other interested parties and to maintain an optimal capital structure to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Group may take a variety of measures such as issue new shares or sell assets to reduce liabilities.

b. Financial instruments:

1. Financial instruments by category:

As of December 31, 2014 and 2013, all financial assets were classified in the category of loans and receivables. Likewise, all financial liabilities as of such dates were classified in the category of other financial liabilities at amortized cost.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 5:- INTERCURE**

On June 13, 2012, the Company entered into an agreement in principle with InterCure, according to which, subject to carrying out the debt settlement pursuant to Article 350 of the Israeli Companies Law, 1999 (the “**Settlement**”) before the transaction, InterCure converted all its debts into ordinary shares of InterCure based on the distribution mechanism determined with all its debtors (including its employees). Once the Settlement was consummated, the Company acquired the control over InterCure in consideration for investing an aggregate amount of approximately \$ 2.7 million, partly in cash and partly by the issuance of Company shares.

On July 25, 2012, the transaction was completed after all the prerequisites had been met and the Company acquired 16,839,532 ordinary shares of InterCure with no par value, in consideration of a private placement of 7,165,662 ordinary shares of the Company of NIS 0.1 par value each, whose value on the date of signing the agreement, measured according to the quoted market price of the Company’s shares on the TASE, was approximately \$ 2.2 million, and which represents a value of InterCure of \$ 1.75 million before the money, but after all of InterCure’s debts were converted as described above (“**InterCure’s Adjusted Value**”). The fair value of the Company’s shares on the date of consummation of the transaction was approximately \$ 2.5 million. In the year ended December 31, 2013, InterCure sold 1,097,719 shares of the Company for an aggregate amount of approximately \$ 283 thousand. In addition, the Company provided InterCure an amount of approximately \$ 150 thousand in cash on the basis of InterCure’s Adjusted Value. After affecting the above allocation, the Company held approximately 50.79% of the issued and outstanding share capital of InterCure. The investment of Medica Fund on the date of closing on the basis of InterCure’s Adjusted Value amounted to approximately \$ 460 thousand.

On October 28, 2012, InterCure allocated 20,185,184 performance-based stock options exercisable into 20,185,184 ordinary shares with no par value to Giboov Ltd. (“**Giboov**”).

On May 16, 2013, the Company informed InterCure of its decision to convert its entire convertible loan which had been extended by the Company in the context of the acquisition into 7,620,695 ordinary shares of InterCure, as predetermined in the original acquisition agreement. Upon conversion, the Company held approximately 54.72% of InterCure’s issued and outstanding share capital.

In November 2014, InterCure announced that its Audit Committee and Board of Directors approved the signing of an agreement with Green Forest Global Ltd. (the “**Agreement**” and “**Green Forest**”, respectively) a company wholly owned

by Mr. Alexander Rabinovitch, an interested party in the Company.

Pursuant to the Agreement, following a reverse split in InterCure shares at a 10:1 ratio, Green Forest will be allotted 2,622,647 ordinary shares of InterCure (the “**First Round Allotted Shares**”) representing 34.23% of the issued and outstanding shares of InterCure at the time of the allotment for an investment of \$ 230 thousand. Further, upon InterCure’s shares return to the main list of the TASE, an additional 2,622,648 ordinary shares of InterCure will be allotted to Green Forest for an additional investment of \$ 230 thousand (the “**Second Round Allotted Shares**”).

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 5:- INTERCURE (Cont.)**

In addition, the Agreement grants Green Forest the following three options:

1. Option to purchase up to an additional 3,416,818 ordinary shares of InterCure for \$ 300 thousand (representing an exercise price of \$ 0.0878 per share), exercisable within 12 months of the Transaction Completion Date, as defined in the Agreement.

2. Option to acquire the Company shares held by InterCure at a price of NIS 0.35 per share, exercisable within 6 months of the Transaction Completion Date.

3. Option to acquire InterCure's assets, rights and obligations relating to the "Resperate" business at the cost of inventory held at the time of the exercise of the option, exercisable within 6 months of the Transaction Completion Date.

Under the Agreement, Green Forest provided InterCure with a qualifying, non-secured, non-guaranteed, non-interest bearing and non-indexed loan of \$ 40 thousand for a period of 60 days. At the time of the completion of the transaction, the loan will be repaid by the sale of shares of the Company held by InterCure to Green Forest for the value of the loan (\$ 40 thousand) at a price of NIS 0.30 per share.

InterCure is granted the right to a Put option to sell all or part of the Company's shares held by InterCure at the Put option exercise date, for an exercise price of NIS 0.30 per share, exercisable within 6 months of the Transaction Completion Date.

In addition, at the time of and as a condition for the completion of the transaction, the outstanding loan of \$ 50 thousand owed by InterCure to the Company will be converted to 569,470 ordinary shares of InterCure.

On December 23, 2014, the extraordinary general meeting of InterCure approved the Agreement. Upon receiving the required approval to the Agreement from TASE, the Agreement turned effective as of February 12, 2015. After the issuance of the 2,622,647 First Round Allotted Shares, as well as the conversion of the loan granted to InterCure into 569,470 ordinary shares of InterCure, the Company's holdings in InterCure were diluted to 36.53% of the issued and outstanding share capital of InterCure.

InterCure's net assets were reclassified in the Group's financial statements for the year ended December 31, 2014, and grouped into two separate items: *Assets of Disposal Group Classified as Held for Sale* and *Liabilities of Disposal Group Classified as Held for Sale*. For additional details, see Note 28 below.

**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 6:- CASH AND CASH EQUIVALENTS**

	December 31,	
	2014	2013
	U.S. dollars in thousands	
Cash in banks and on hand	1,348	1,010
Bank deposits for periods of three months or less	811	1,877
	2,159	2,887

The currencies in which the cash and cash equivalents are denominated or linked to are:

	December 31,	
	2014	2013
	U.S. dollars in thousands	
U.S. dollars	1,266	2,199
NIS (not linked to the Israeli CPI)	892	680
Other currencies	1	8
	2,159	2,887

**NOTE 7:- SHORT-TERM DEPOSITS**

- a. The currencies in which the short-term deposits are denominated:

	December 31,	
	2014	2013
	U.S. dollars in thousands	
U.S. dollars	-	500
NIS (not linked to the Israeli CPI)	-	778

- 1,278

b. The Company has a restricted deposit in connection with its office lease agreement. As of December 31, 2014 and 2013, the restricted deposit balance was \$ 21 thousand and \$ 23 thousand, respectively.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 8:- TRADE RECEIVABLES**

	December 31,	
	2014	2013
	U.S. dollars in thousands	
Open debts	-	90
Credit cards	-	42
Less - allowance for doubtful accounts	-	(6 )
	-	126

\*)In 2014 - amounts are included in *Non-Current Assets of Disposal Group Classified as Held for Sale*.

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**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 9:- OTHER ACCOUNTS RECEIVABLE**

## a. Composition:

	December 31,	
	2014	2013
	U.S. dollars in thousands	
Government authorities	58	67
Prepaid expenses	366	106
Receivables due to sale of investment in Proteologics	-	297
Other receivables	13	3
	437	473

b. The currencies in which other accounts receivable which are monetary items are denominated or to which they are linked are as follows:

	December 31,	
	2014	2013
	U.S. dollars in thousands	
U.S. dollars	-	-
NIS	71	367
	71	367

The carrying amount of other accounts receivable is a reasonable approximation of the fair value because the effect of discounting is immaterial.

**NOTE 10:- INVENTORIES**

December 31,  
2014 2013



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U.S. dollars in thousands

Raw and auxiliary materials	-	52
Finished goods	-	250
	-	302

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**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 11:- ADDITIONAL INFORMATION ABOUT INVESTMENT IN INVESTEEES**

Name and country of incorporation of subsidiary	Date	Equity interests and voting rights	Scope of investments in investee (in \$ 000)	Stock Exchange data	Dividends received or receivable
1 Xtepo Ltd., incorporated in Israel	31.12.2014	100	% 3,685	-	-
	31.12.2013	100	% 3,862	-	-
2 XTL Biopharmaceuticals Inc., incorporated in Delaware *)	31.12.2014	-	-	-	-
	31.12.2013	100	% (144 )	-	-
3 InterCure Ltd., incorporated in Israel	31.12.2014	54.72	% 1,736 )**	TASE, value of shares as of 31.12.14 - \$ 308 thousand	-
	31.12.2013	54.72	% 2,144 )***	TASE, value of shares as of 31.12.13 - \$ 754 thousand	-

\*) Dissolved during 2014.

\*\*\*) Includes Treasury Shares in the amount of \$ 1,501 thousand.

\*\*\*\*) Includes Treasury Shares in the amount of \$ 2,091 thousand.

Set out below is the summarized financial information for InterCure as of December 31, 2014 and 2013 and for the respective years then ended:

**a. InterCure Ltd. – Summarized consolidated balance sheet \*)**

	December 31,	
	2014	2013
	U.S. dollars in thousands	
Current assets**	678	1,623
Current liabilities	476	634
Total current net assets	202	989

Non-current assets***	255	440
Non-current liabilities****	73	11
Total non-current net assets	182	429
Net assets	384	1,418

\*\*Including treasury shares of the Company, presented at fair value.

\*\*\*Including intangible assets, net, recognized in the Company's purchase of InterCure.

\*\*\*\*Including loan received from the Company in the amount of \$ 50 thousand.

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**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 11:- ADDITIONAL INFORMATION ABOUT INVESTMENT IN INVESTEEES (Cont.)****b. InterCure Ltd. - Summarized consolidated income statement \*)**

	Year ended December 31,	
	2014	2013
	U.S. dollars in thousands	
Revenue	1,451	2,369
Profit (loss) before income tax**	(1,016 )	(3,887 )
Income tax income (expense)	-	-
Post-tax profit (loss) from continuing operations	(1,016 )	(3,887 )
Other comprehensive gain (loss)	28	73
Total comprehensive loss	(988 )	(3,814 )
Total comprehensive loss allocated to non-controlling interests	(447 )	(1,787 )

\*\* Including amortization and impairment of intangible assets, net, recognized in the Company's purchase of InterCure.

**c. InterCure Ltd. - Summarized consolidated cash flows \*)**

	December 31,
	2014
	U.S. dollars in thousands
Net cash used in operating activities	(487 )
Net cash generated from investing activities	230
Net cash generated from (used in) financing activities	90
Net decrease in cash and cash equivalents	(167 )

Cash and cash equivalents at beginning of year	220
Cash and cash equivalents at end of year	53

\*)The information above is the amount before inter-company eliminations.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 12:- INVESTMENT IN ASSOCIATE**

In November 2012, in an off-market transaction, the Company acquired from Teva Pharmaceutical Industries Ltd. (“**Teva**”) 4,620,356 ordinary shares of Proteologics Ltd. (“**Proteologics**”), representing Teva’s entire stake in <sup>a</sup>Proteologics - approximately 31.35% of Proteologics’ issued and outstanding share capital – in consideration of approximately \$ 1.7 million.

Proteologics is a public company traded on the TASE which at the time of the acquisition of its shares by the Company, was engaged in the discovery and development of drugs operating on various components of the Ubiquitin system.

In August 2013, Proteologics’ board of directors resolved to terminate Proteologics’ operations effective immediately.

In September 2013, the Company signed an agreement with Zmiha Investment House Ltd. (“**Zmiha**”) for the sale of its entire investment in Proteologics, representing 44.95% of Proteologics’ issued and outstanding share capital as of the date of the agreement, after having purchased an additional 14.13% of the shares of Proteologics from Aurum Ventures MKI Ltd. (“**Aurum**”) in September 2013, in consideration for the issuance of 3,031,299 shares of NIS 0.1 par value each of the Company to Aurum. Consideration for the sale to Zmiha totaled approximately \$ 3.4 million. The Company received an amount of approximately \$ 2.7 million in 2013, with the remaining balance of received in 2014.

b. The amounts recognized in the income statement are as follows:

	December 31,	
	2014	2013
	U.S. dollars in thousands	
Equity gains (losses)	-	(845 )
Gain due to exercise of options in associate	-	10
	-	1,051

Capital gain  
from sale of  
investment

- 216

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**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 13:- PROPERTY, PLANT AND EQUIPMENT**

## a. Composition and movement:

The composition of property, plant and equipment and accumulated depreciation, by major classes, and the movement therein in 2014 are:

	Office furniture and equipment	Computers	Production molds	Total
	U.S. dollars in thousands			
Cost:				
Balance at January 1, 2014	24	86	51	161
Additions during the year	2	4	-	6
Disposals during the year	(1 )	(2 )	(51 )	(54 )
Balance at December 31, 2014	25	88	-	113
Accumulated depreciation:				
Balance at January 1, 2014	5	75	20	100
Additions during the year	3	6	1	10
Disposals during the year	-	-	(21 )	(21 )
Balance at December 31, 2014	8	81	-	89
Depreciated cost at December 31, 2014	17	7	-	24



**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 13:- PROPERTY, PLANT AND EQUIPMENT (Cont.)**

The composition of property, plant and equipment and accumulated depreciation, by major classes, and the movement therein in 2013 are:

	Office furniture and equipment	Computers	Production molds	Total
U.S. dollars in thousands				
Cost:				
Balance at January 1, 2013	38	83	51	172
Additions during the year	-	11	-	11
Disposals during the year	(14 )	(8 )	-	(22 )
Balance at December 31, 2013	24	86	51	161
Accumulated depreciation:				
Balance at January 1, 2013	15	75	10	100
Additions during the year	2	8	10	20
Disposals during the year	(12 )	(8 )	-	(20 )
Balance at December 31, 2013	5	75	20	100
Depreciated cost at December 31, 2013	19	11	31	61

**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 14:- INTANGIBLE ASSETS**

## a. Composition and movement:

The composition of intangible assets and accumulated amortization, by major classes, and the movement therein in 2014 are:

	Licenses and patent rights	Technology	Brand name	Software	Total
	U.S. dollars in thousands				
Cost:					
Balance at January 1, 2014	2,457	1,909	488	153	5,007
Additions during the year	41	-	-	-	41
Disposal	-	-	-	(153)	(153)
Reclassification to non-current assets held for sale	-	(1,909)	(488)	-	(2,397)
Balance at December 31, 2014	2,498	-	-	-	2,498
Accumulated amortization:					
Balance at January 1, 2014	-	1,676	427	39	2,142
Additions during the year	-	31	7	5	43
Disposal	-	-	-	(44)	(44)
Reclassification to non-current assets held for sale	-	(1,707)	(434)	-	(2,141)
Balance at December 31, 2014	-	-	-	-	-
Amortized cost at December 31, 2014	2,498	-	-	-	2,498

**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 14:- INTANGIBLE ASSETS (Cont.)**

The composition of intangible assets and accumulated amortization, by major classes, and the movement therein in 2013 are:

	Licenses and patent rights	Technology	Brand name	Software	Total
	U.S. dollars in thousands				
Cost:					
Balance at January 1, 2013	2,457	1,909	488	153	5,007
Balance at December 31, 2013	2,457	1,909	488	153	5,007
Accumulated amortization:					
Balance at January 1, 2013	-	92	21	8	121
Additions during the year	-	212	49	31	292
Impairment	-	1,372	357	-	1,729
Balance at December 31, 2013	-	1,676	427	39	2,142
Amortized cost at December 31, 2013	2,457	233	61	114	2,865

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 14:- INTANGIBLE ASSETS (Cont.)**

On August 3, 2010, the Company completed the share swap transaction with the shareholders of Bio-Gal Ltd. (the “**Transaction**”) in which the Company acquired 100% of the shares of Xtepo, which for the Transaction purposes held an exclusive license to use the patented recombinant EPO (rHuEPO) drug for treating Multiple Myeloma and also held cash totaling approximately \$ 1.5 million on the date of completion of the transaction, in return for the allocation of 133,063,688 ordinary shares of NIS 0.1 par value each, representing approximately 69.44% of the Company’s issued and outstanding share capital after completion of the Transaction.

Following the closing of the Transaction, the Company recognized in its accounts an intangible asset representing the license for the exclusive use of the patent for the rHuEPO drug for Multiple Myeloma as well as every clinical study and accumulated knowhow underlying the patent in a total of approximately \$ 2,265 thousand (excluding transaction costs of approximately \$ 187 thousand), based on its fair value as of the date of closing of the Transaction according to an independent external valuation.

On May 29, 2011, the Company received the approval of the FDA, a subdivision of the U.S. Health and Human Services, for orphan drug status for the rHuEPO drug which is patented by the Company until 2019. An “orphan drug” is defined as a drug for treating diseases that affect a relatively small number of people. In the U.S., an “orphan drug” is defined as a disease affecting fewer than 200,000 people a year. To encourage the development of drugs for these diseases, the different regulatory authorities grant benefits and incentives to developers. The main standard benefit of orphan drugs in the U.S. is receiving seven years marketing exclusivity from the date of marketing approval by the FDA, once the FDA gives such approval. Other benefits are local U.S. tax credits for research and development expenses and waiver of FDA filing fees.

According to the guidance of IAS 38, this asset is not systematically amortized and the Company reviews the asset for impairment once a year or more frequently if indicators show that the asset may be impaired.

In December 2014, the Company tested the asset for impairment with the assistance of a consultant in accordance with the guidance of IAS 36. According to the valuation performed, there is no need to reduce the value of the asset in relation to its carrying amount. Since there are no similar transactions according to which the fair value of the patent can be determined, the value of the patent was determined by the value in use on the basis of the discounted future cash flow method for the years 2015 to 2028. The discount period was determined on the basis of the estimated schedules to perform the clinical trials in order to approve the drug for marketing and under the limitation of the patent years and the orphan drug designation as above.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 14:- INTANGIBLE ASSETS (Cont.)**

The key assumptions used by the external expert in measuring value-in-use as of December 31, 2014 are: life of phase 2 and 3 clinical trials of 2 and 3.5 years, respectively, expected penetration levels from 10% in 2022 to 55% in 2026-2028 out of an estimate of 63,868 new cases of Multiple Myeloma diagnosed each year, royalties at the rate of 12.5% and (pre-tax) discount rate of 27%.

On September 1, 2010, the Company and Yeda Research and Development Co. Ltd. (“**Yeda**”) entered into a license agreement of an exclusive right to examine a medical technology in the field of the immune system, comprising two proteins through which target molecules are examined and may serve as a basis for the development of therapeutics for diseases relating to the immune system, such as acute Hepatitis, rheumatoid arthritis, Crohn’s disease, psoriasis etc. Under the agreement, the Company purchased this exclusive right to examine the medical technology for a 15-month period in consideration of \$ 120 thousand (the “**Option Fee**”) payable by the Company in the following manner and at the earlier of: (i) in the event of a capital raising by a public prospectus of more than \$ 2 million, the Company is obligated to settle the payment to Yeda in cash; or (ii) if 12 months after the date of closing of the agreement an amount of more than \$ 2 million is not raised, the liability to Yeda can be satisfied, at the Company’s election and after obtaining Yeda’s approval to the timing, in cash or by issuance of Company stock options with an equivalent value. The Company’s option to purchase said technology expired on November 30, 2011 and the Company elected not to exercise the option.

On July 11, 2013, the Company and Yeda entered into an amendment to the license agreement, according to which the Company shall pay Yeda an amount of \$ 120 thousand in the following manner: (a) \$ 30 thousand in cash, payable as of the date of the amendment, and (b) an additional amount of \$ 90 thousand shall be paid by the Company to Yeda upon the earlier of: (a) a capital raise in the amount of \$ 2 million and (b) upon the consummation of a transaction relating to the Company’s Erythropoetin technology with any third party, which includes the receipt by the Company of a consideration of at least \$ 2 million.

On November 30, 2011, the Company completed the MinoGuard transaction according to which the Company acquired the activity of MinoGuard Ltd. (“**MinoGuard**”), founded by Mor Research Applications Ltd. (“**Mor**”), by obtaining an exclusive license to MinoGuard’s entire technology, including the SAM-101 drug (combined drug to d. treat mental disorders focusing on schizophrenia) in return for royalties on sales and milestone payments to be provided throughout the clinical development process. The drug is based on a combination of existing antipsychotic drugs and a known medicinal compound (Minocycline). For more details regarding the engagement with MinoGuard, see Note 18a(3) below.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 14:- INTANGIBLE ASSETS (Cont.)**

As for intangible assets recognized for the first time after the completion of the InterCure transaction, as presented in Note 5 above, and due to a significant decline in InterCure's share price as quoted on the TASE as of December 31, 2013, the Company hired the services of an external independent expert in order to establish whether or not an impairment exist in connection with the technology and brand name assets recognized in the purchase price allocation study of InterCure.

The recoverable amount was assessed by management with the assistance of a consultant. In light of recent developments in InterCure, namely conclusions reached by its management and board of directors regarding its ability to continue operating as a going concern, several scenarios were taken into account by the expert. Each scenario was assigned a different weight in order to accommodate all scenarios into a weighted-average discounted cash flow. Such scenarios were as follows:

(i) The liquidation scenario, under which the realizable value of InterCure's net operational assets was estimated, was assigned a weighting of 60%.

(ii) The going concern scenario, establishing the value-in-use of InterCure's operations using the discounted cash flow method, was assigned a weighting of 40%. The value-in-use calculations use pre-tax cash flow projections covering an eight-year period and using extrapolation with specific adjustments expected until 2021, and a pre-tax discount rate of 33.3%. The value-in-use calculations included all factors in nominal terms.

The impairment test was based on assessments of financial performance and future strategies in light of current and expected market and economic conditions. Trends in the economic and financial environment, competition and regulatory authorities' decisions, or changes in competitors' behavior in response to the economic environment may affect the estimate of recoverable amounts in future periods.

For the purpose of the impairment test, InterCure was considered the lowest level for which there are separately identifiable cash flows – a Cash Generating Unit (“CGU”). Upon examination, the expert concluded that an impairment exists, and that InterCure's recoverable amount stands at \$ 300 thousand. The impairment loss in the amount of \$ 1.8 million was recognized in loss from operations, and allocated between said intangible assets of the CGU pro rata, based on their respective carrying amounts (net of amortization), in the following amounts:

- (a) Technology – \$ 1.4 million;
- (b) Brand Name – \$ 357 thousand.

As of December 31, 2014, the Technology and Brand Name carried net amortized book values of \$ 202 thousand and \$ 53 thousand, respectively. The Company's management estimates that transactions in InterCure during and after the reporting period provide sufficient evidence that no further impairment is required with regard to these intangible assets.

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**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 14:- INTANGIBLE ASSETS (Cont.)**

On January 7, 2014, the Company signed a licensing agreement with Yeda to develop hCDR1, a Phase II-ready asset for the treatment of Systemic Lupus Erythematosus (“SLE”). The terms of the licensing agreement include, among other things, expense reimbursement for patent expenses payable in six installments (see below), certain milestone payments to Yeda, low single-digit royalties based on net sales, and additional customary royalties to the Office of the Chief Scientist.

On May 14, 2014, the Company issued 222,605 ordinary shares of the Company of NIS 0.1 par value each to Yeda, as the first of six installments for the aforementioned patent expenses reimbursement, representing a value of approximately \$ 38 thousand. For additional information, see Note 30 below.

**NOTE 15:- TRADE PAYABLES**

a. Composition:

	December 31,	
	2014	2013
	U.S. dollars in thousands	
Open accounts *)	139	455
Checks payable *)	78	160
	217	615

The carrying amount of trade payables is a reasonable approximation of their fair value because the effect of discounting is immaterial.

b. The carrying amount of trade payables is denominated in the following currencies:

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December 31,  
2014            2013  
U.S. dollars in thousands

U.S. dollars *)	110	405
NIS (not linked to the Israeli CPI *)	107	208
Others	-	2
	217	615

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**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 16:- OTHER ACCOUNTS PAYABLE**

a. Composition:

	December 31,	
	2014	2013
	U.S. dollars in thousands	
Employees, consultants and payroll accruals	29	199
Provision for returns	-	45
Deferred revenue	-	35
Authorities	-	86
Accrued expenses	269	239
Other	-	-
	298	604

The carrying amount of other accounts payable is a reasonable approximation of their fair value because the effect of discounting is immaterial.

b. The carrying amount of other accounts payable is denominated in the following currencies:

	December 31,	
	2014	2013
	U.S. dollars in thousands	
U.S. dollars	269	405
NIS (not linked to the Israeli CPI)	22	105
Other	7	94
	298	604

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 17:- EMPLOYEE BENEFIT LIABILITIES**

According to the effective labor laws and employment agreements in Israel and overseas, the Company and the a. subsidiaries are obligated to pay compensation and/or pension to employees who are dismissed and, under certain circumstances, to employees who retire.

The Company's obligation for pension payment in Israel and the Company's obligation for compensation payments to employees in Israel for whom the applicable obligation is pursuant to section 14 to the Severance Pay Law, are b. covered by fixed contributions into defined contribution plans. The amounts contributed as above are not reflected in the statements of financial position. In 2014, section 14 to the Severance Pay Law applied to most of the Company's employees.

The amount recognized as an expense for defined contribution plans in 2014, 2013 and 2012 was \$ 25 thousand, \$ 26 thousand and \$ 23 thousand, respectively.

InterCure has an obligation to pay severance to an employee, which represents a defined benefit plan. InterCure has severance pay funds and executive insurance policies in which it deposits funds in respect of this obligation. The c. amount of accrued severance pay, net included in the statements of financial position as of December 31, 2014 and 2013 reflects the difference between the accrued severance pay and the severance pay funds.

Since as of December 31, 2014, section 14 to the Severance Pay Law applies to all of the Company's employees, as above, pursuant to which they are covered by fixed contributions to defined contribution plans, no contributions to defined benefit plans are expected for the year ending December 31, 2015.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 18:- COMMITMENTS**

a. Royalty and contingent milestone payments:

On March 14, 2012, the Company signed a strategic collaboration master agreement with Clalit Health Services - Clalit Research Institute Ltd. (the “**Institute**”) and Mor Research Applications Ltd. (“**Mor**”) according to which the Institute provides the Company the right to receive data which are based on the Institute’s database in connection with technologies that stem from inventions and patents of Clalit Health Services’ physicians, in projects whose content shall be agreed upon by the Company, the Institute and Mor in advance and in writing.

In consideration for the above, the Company will pay the Institute the cost basis related to the Institute’s activity in the framework of any project plus an additional 10% of the total royalties to which Mor is entitled pursuant to its agreements with the Company in connection with each technology where rights were granted to the Company.

This agreement may be terminated by a 180-day advance written notice by any of the parties on condition that all joint active projects have reached their end. As of the date of the approval of the financial statements, the Company has no active projects with the Institute.

On November 30, 2011, the Company completed the MinoGuard transaction according to which an exclusive license to the SAM-101 drug (combined drug to treat mental disorders focusing on schizophrenia) was transferred to the Company. According to the terms of the agreement with MinoGuard, the Company will act to conduct clinical trials, develop, register, market, distribute and sell the drug candidates that will emerge from the technology, with no limitations to a specific disorder.

In return for the receipt of the license, as above, the Company will pay MinoGuard cumulative milestone payments throughout the research and development and the approval of the drug in an aggregate of \$ 2.5 million. In addition, the Company will make royalty payments to MinoGuard of 3.5% on sales of products derived from the license and/or a percentage of the Company’s net income of any third-party sublicense in the range of 7.5% to 20% depending on the clinical phase of the drug at the time of the above sublicense transaction.

**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 18:- COMMITMENTS (Cont.)**

In addition to the above payments, if the Company does not commence a phase 2 clinical trial by June 30, 2013 (the agreement states that receipt of an approval to commence such trial or continuance of the clinical trials that were conducted/will be conducted by MinoGuard and/or its researchers, shall be deemed commencement of phase 2 clinical trial for this matter), the Company will then pay MinoGuard an annual license fee of \$ 45 thousand for the first payment and its cost will increase by \$ 90 thousand per year (should the trial not commence) up to \$ 675 thousand for the eighth year of license. The Company can pay any of the above amounts in cash or by issuance of securities to MinoGuard, at its sole discretion. In accordance with the agreement, and since as of June 30, 2013, the Company had not commenced a phase 2 clinical trial, it has paid MinoGuard an annual license fee, by way of issuance of 175,633 ordinary shares of the Company, representing a value of \$ 45 thousand, for the 12 month period between July 1, 2013 and June 30, 2014. On September 3, 2014, the Company issued an additional 889,822 ordinary shares, representing a value of \$ 135 thousand, for the 12 month period between July 1, 2014 and June 30, 2015.

The licensed technology transferred to the Company is protected by a registered patent through 2027. If the Company does not commence a phase 2 clinical trial (as described above) within 9.5 years from the date of the license agreement, the license will expire.

As stated in Note 14c above, on August 3, 2010, the Company closed the Bio-Gal Transaction. According to this agreement, the Company is obligated to pay 1% royalties on net sales of the product and \$ 350 thousand upon the successful completion of a phase 2 clinical trial. The payment conditions for the above amount are at the earlier of occurrence of the following events:

3. (i) Raising capital of at least \$ 2 million by the Company or Xtepo after a successful completion of a phase 2 clinical trial;
- (ii) Six months after the successful completion of a phase 2 clinical trial.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 18:- COMMITMENTS (Cont.)**

c. Operating lease commitments:

1. The Company entered into an operating lease agreement on the offices it uses. The agreement is in effect until August 2015. The lease fees are stated in NIS and are linked to the Israeli CPI. To secure the lease, the Company provided a bank guarantee, which is secured by a restricted NIS deposit of approximately \$ 21 thousand.

The expected lease fees and management fees for subsequent years under the prevailing lease fees as of December 31, 2014 are as follows:

U.S. dollars  
in thousands

2015 53

The Company entered into agreements with subtenants to lease part of the office space in exchange for approximately \$ 1,000 per month. The agreement is in effect until August 2015.

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**XTL BIOPHARMACEUTICALS LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014****NOTE 19:- SHARE CAPITAL, RESERVES AND RETAINED EARNINGS**

a.		Composition:							
Number of shares				Amount					
Authorized		Issued and outstanding		Authorized		Issued and outstanding			
December 31, 2014		December 31, 2013		December 31, 2014		December 31, 2013			
In thousands				NIS in thousands					
ordinary shares of NIS 0.1	700,000	700,000	237,167**	232,895 **	70,000	70,000	23,717 **	23,289 **	
*									

\* Traded on the TASE. The Company's ADSs are listed for trading on the Nasdaq Capital Market in the U.S. The share price was NIS 0.382 as of December 31, 2014.

\*\* Including 4,354,881 and 6,067,943 treasury shares held by InterCure as of December 31, 2014 and 2013, respectively, as 1,713,062 treasury shares were sold by InterCure in 2014.

b. Ordinary shares confer upon their holders voting rights and right to participate in the shareholders' meeting, right to receive dividends and the right to participate in the excess of assets upon liquidation of the Company.



**XTL BIOPHARMACEUTICALS LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2014**

**NOTE 19:- SHARE CAPITAL, RESERVES AND RETAINED EARNINGS (Cont.)**

On January 14, 2014, the general meeting of shareholders and the general meeting of warrant (series 2) holders of the Company resolved to approve the extension of the term of warrants (series 2) of the Company from December 31, 2013 to October 28, 2014, subject to the approval of the Tel-Aviv-Jaffa district court (the “**Court**”), and pursuant to Section 350 to the Israeli Companies Law, 1999.

On October 28, 2014, the outstanding 12,217,106 warrants (series 2) expired.

On March 18, 2012, the Company’s Board approved a private placement to institutional and private investors (foreign as well as Israeli) for the total of approximately \$ 2.4 million (approximately NIS 9.1 million) net of issuance expenses of approximately \$ 19 thousand. According to the private placement, the Company allocated 11,560,362 ordinary shares of the