

BOS BETTER ONLINE SOLUTIONS LTD  
Form 6-K  
October 01, 2007

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**FORM 6 K**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Report of Foreign Issuer

Pursuant to Rule 13a - 16 or 15d -16  
of the Securities Exchange Act of 1934

For the Month of October 2007

**B.O.S. Better Online Solutions Ltd.**

(Translation of Registrant's Name into English)

20 Freiman Street, Rishon LeZion, 75100, Israel  
(Address of Principal Corporate Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F  Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): \_\_\_\_\_

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): \_\_\_\_\_

Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes  No

If  Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

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THIS FORM 6-K IS HEREBY INCORPORATED BY REFERENCE INTO THE REGISTRANT'S REGISTRATION STATEMENTS ON FORM F-3 (NO. 333-130048) AND FORM S-8 (NOS. 333-136957, 333-110696, 333-100971 AND 333-11650), AND TO BE A PART THEREOF FROM THE DATE ON WHICH THIS REPORT IS SUBMITTED, TO THE EXTENT NOT SUPERSEDED BY DOCUMENTS OR REPORTS SUBSEQUENTLY FILED OR FURNISHED.

Attached hereto and incorporated by reference are the Unaudited Interim Consolidated Financial Statements of the Registrant as of June 30, 2007.

Signature

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

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B.O.S. Better Online Solutions Ltd.  
(Registrant)

By: /s/ Shmuel Koren

Shmuel Koren  
President and CEO

Dated: October 1, 2007

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## Management's Discussion and Analysis of Results of Operations and Financial Condition for the six months ended June 30, 2007 and 2006

### RESULTS OF OPERATION

Revenues for the six months ended June 30, 2007 amounted to \$11,072 thousands, a 15.8% increase over the Company's revenues for the six months ended June 30, 2006, which reflected a 20% increase in the revenues of our Supply-Chain solution segment to \$10,248 thousands, which was partially offset by a 20% decrease in the revenues of our Software solutions segment to \$824 thousands during this period. The increase in revenues of the Supply-Chain solution segment was due to the continued expansion of its sales to customers in the Israeli market, including to the Israeli Aircraft Industry, as well as to customers in the United States and Western Europe markets. The decrease in revenues of the Software solutions segment was primarily related to sales of our System i products. In the first half of year 2007 we developed and enhanced the product line of the Software Solution segment, in order to increase our sales in this segment.

Gross profit for the six months ended June 30, 2007 was \$2,406 thousand, or 21.7% of revenues, as compared to \$2,319 thousands or 24.3% of revenues for the six months ended June 30, 2006. The major reason for the decrease in gross profit relates to the increase in the portion of Supply-Chain solution sales over Software solutions sales, since the gross margin rate of the Supply-Chain Solution sales is lower than the gross margin rate of the Software solution sales. The sales of Supply-Chain solution in the first six months of year 2007 accounted for 92.6% of consolidated revenues, compared to 89.3% from the sales of the six months ended June 30, 2006. The gross margin rate of the Supply-Chain solution segment was 17.2% and 19.4% in the six months ended June 30, 2007 and 2006, respectively, as compared to the gross margin rate of the Software Solution segment which was 78.5% and 65.3% in the six months ended June 30, 2007 and 2006, respectively.

Sales and marketing expenses for the six months ended June 30, 2007 were \$1,470 thousands as compared to \$996 thousands for the six months ended June 30, 2006. General and administrative expenses for the six months ended June 30, 2007 were \$973 thousands compared to \$1,534 thousands for the six months ended June 30, 2006. The changes in the expenses between the six months ended June 30, 2007 and the parallel period in 2006, was primarily the result of a change in the presentation of management and operation expenses of our subsidiary, Odem Electronic Technologies 1992 Ltd. (Odem), to classify such expenses as sales and marketing expenses commencing in the second quarter of 2007 while in the first six months of 2006 such expenses were presented under the general and administrative expenses. The reason for the change in presentation relates to the change in the organization structure of the Company that was completed at the beginning of the second quarter of 2007 which includes, among others, change of the Company management that centralized the management of Odem with that of the Company and combined the facilities of the Company and Odem.

Operating expenses for the six months ended June 30, 2007 decreased to \$2,665 thousand from \$2,819 thousand in six months ended June 30, 2006. The decrease was primarily due to a decrease in stock based compensation which amounted to \$288 thousand in the six months ended June 30, 2007 as compared to \$405 thousands in the six months ended June 30, 2006.

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Financial expenses increased to \$354 thousand in the six months ended June 30, 2007 as compared to \$206 thousands in the six months ended June 30, 2006, primarily as a result of an increase in the outstanding principal balance of convertible notes which increased to \$2,200 thousands up until June 21, 2007 as compared to principal amount of \$1,395 thousands as of June 30, 2006.

On June 21, 2007, Laurus Master Fund Ltd., the holder of the Company's convertible notes, converted the entire outstanding principal amount of the notes, of \$ 2,200 thousands, into Ordinary Shares. Following the conversion and as a result of reduction in conversion price of the convertible note, the Company recorded a non-cash expense in the second quarter of 2007, in the amount of \$611 thousand.

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As a result of the foregoing, net loss from continuing operations for the six months ended June 30, 2007 was \$1,150 thousands (basic and diluted loss of \$0.15 per share) as compared to a net loss of \$732 thousand (basic and diluted loss of \$0.10 per share) for the six months ended June 30, 2006.

The Company has accounted for the communication segment that was sold on December 31, 2005, as a discontinued operation, in accordance with EITF 03-13 Applying the Conditions in Paragraph 42 of FASB Statement 144 in Determining Whether to Report Discontinued Operations. Income related to discontinued operation for the six months ended June 30, 2006 was \$906 thousands (basic and diluted earning of \$0.13 per share). No income or expenses related to the discontinued operation were recorded in the six months ended June 30, 2007.

Net loss for the six months ended June 30, 2007 was \$1,150 thousands (basic and diluted loss of \$0.15 per share) as compared to net income of \$174 thousands (basic and diluted earning of \$0.03 per share) in the six months ended June 30, 2006.

### Liquidity and Capital Resources

We finance our activities by different means, including equity financings, long and short term loans, and income from operating activities.

As of June 30, 2007, our shareholders' equity amounted to \$18,537 thousand as compared to \$12,349 thousand as of December 31, 2006. As of June 30, 2007 cash and cash equivalents increased to \$5,616 thousand from \$2,033 thousands in December 31, 2006. Short term and long term loan and convertible note were reduced to \$4,395 thousands as of June 30, 2007 as compared to \$5,259 thousands in December 31, 2006.

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Net cash used in operating activities from continuing operations in the six months ended June 30, 2007 increased to \$2,091 thousands from \$1,323 thousands in the six months ended June 30, 2006. The main reason for the increase was due to a 20% growth in Supply-Chain revenues in the six months ended June 30, 2007 over the comparable period in year 2006, which required an increase in working capital.

Net cash used in investing activities from continuing operations in the six months ended June 30, 2007 amounted to \$112 thousands which was used mainly for investing in property and equipment. Net cash provided by investing activities from continuing operations in the six months ended June 30, 2006 amounted to \$927 thousands which was due mainly to proceeds from the sale of marketable securities.

Net cash provided by financing activities in the six months ended June 30, 2007 amounted to \$5,786 thousands which related to a rights offering in which the Company issued 1,739,398 ordinary shares in consideration for gross proceeds of \$4,400 thousands, based on share price of \$2.50. On June 26, 2007, the company raised gross proceeds of \$600 thousands in consideration for the issuance of 226,415 Ordinary Shares at a price per share of \$2.65 to a European private investor. On June 21, 2007, Laurus Master Fund Ltd., converted the entire outstanding principal amount under its Convertible Notes, of \$2,033 thousands into 878,670 Ordinary Shares of the company. The conversion had no effect on the cash flows.

Working capital requirements will vary from time-to-time and will depend on numerous factors, including but not limited to, growth in revenues mainly of our Supply-Chain segment, operating results, the level of resources devoted to research and development, new product introductions, marketing and acquisition activities.

We have in-balance sheet financial instruments and off-balance sheet contingent commitments. Our in-balance sheet financial instruments consist of our assets and liabilities. Our cash is invested in short-term (less than 3 months) U.S. dollars and NIS interest bearing deposits with banks. As of June 30, 2007, our average trade receivables and trade payables days are 87 and 47 days, respectively.

The fair value of our financial instruments is similar to their book value. Our off-balance sheet contingent commitments consist of: (a) royalty commitments to the Israeli Office of the Chief Scientist and to the Israeli Government through the overseas Marketing Fund that are directly related to our future revenues, (b) lease commitments of our premises and vehicles, (c) directors and officers' indemnities, in excess of the proceeds received from liability insurance which we obtain, and (d) legal proceedings.

We believe that cash resources are sufficient to meet our needs for at least 12 months following the date of this submission. However, it is our intention to seek to obtain additional equity and loan financing to advance our feature-rich products, establish distribution channels in new markets and for new merger and acquisition opportunities. There is, however, no assurance that we shall be able to obtain such financing.

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### B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES

## INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF JUNE 30, 2007

U.S. DOLLARS IN THOUSANDS

UNAUDITED

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**B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

U.S. dollars in thousands

|  | <u>June<br/>30, 2007</u> | <u>December<br/>31, 2006</u> |
|--|--------------------------|------------------------------|
|  | <u>(Unaudited)</u>       |                              |
| <b>ASSETS</b>                                  |                          |                              |
| <b>CURRENT ASSETS:</b>                         |                          |                              |
| Cash and cash equivalents                      | \$ 5,616                 | \$ 2,033                     |
| Trade receivables                              | 5,501                    | 5,632                        |
| Other accounts receivable and prepaid expenses | 1,041                    | 858                          |
| Inventories                                    | 4,570                    | 4,017                        |
|  | <u>16,728</u>            | <u>12,540</u>                |
| <b>Total current assets</b>                    | <b>16,728</b>            | <b>12,540</b>                |
| <b>LONG-TERM ASSETS:</b>                       |                          |                              |
| Severance pay fund                             | 527                      | 741                          |
| Investment in other companies                  | 8,082                    | 8,082                        |
| Other  | 24                       | 65                           |
|  | <u>8,633</u>             | <u>8,888</u>                 |
| <b>Total long-term assets</b>                  | <b>8,633</b>             | <b>8,888</b>                 |
| <b>PROPERTY, PLANT AND EQUIPMENT, NET</b>      | <b>561</b>               | <b>520</b>                   |

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|                    | June<br>30, 2007 | December<br>31, 2006 |
|--------------------|------------------|----------------------|
| CUSTOMER LIST, NET | 1,527            | 1,629                |
| GOODWILL           | 952              | 952                  |
|                    | 3,040            | 3,101                |
|                    | \$ 28,401        | \$ 24,529            |

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**B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

U.S. dollars in thousands

|   | June<br>30, 2007 | December<br>31, 2006 |
|---|------------------|----------------------|
|   | (Unaudited)      |                      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                     |                  |                      |
| <b>CURRENT LIABILITIES:</b>                                     |                  |                      |
| Short term bank loans   | \$ 2,844         | \$ 2,931             |
| Current maturities of long-term bank loans and convertible note | 569              | 1,157                |
| Trade payables  | 2,890            | 3,844                |
| Employees and payroll accruals                                  | 438              | 460                  |
| Deferred revenues   | 148              | 103                  |
| Accrued expenses and other liabilities                          | 753              | 999                  |
| <b>Total current liabilities</b>                                | <b>7,642</b>     | <b>9,494</b>         |
| <b>LONG-TERM LIABILITIES:</b>                                   |                  |                      |
| Bank loans (net of current maturities)                          | 982              | -                    |
| Convertible note (net of current maturities)                    | -                | 1,171                |
| Deferred taxes  | 345              | 362                  |
| Accrued severance pay   | 658              | 916                  |
| Other long-term liabilities                                     | 237              | 237                  |
| <b>Total long-term liabilities</b>                              | <b>2,222</b>     | <b>2,686</b>         |

**SHAREHOLDERS' EQUITY**

Ordinary shares of NIS 4.00 par value- Authorized: 35,000,000 shares at June 30, 2007 and December 31, 2006; Issued and Outstanding 9,601,033 and

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|  | June<br>30, 2007 | December<br>31, 2006 |
|--|------------------|----------------------|
| 6,744,798 shares at June 30, 2007 and December 31, 2006, respectively; | 9,346            | 6,571                |
| Additional paid-in capital   | 52,891           | 48,330               |
| Accumulated other comprehensive income                                 | 19               | 19                   |
| Accumulated deficit  | (43,719)         | (42,571)             |
| <b>Total shareholders' equity</b>                                      | <b>18,537</b>    | <b>12,349</b>        |
| <b>Total liabilities and shareholder's equity</b>                      | <b>\$ 28,401</b> | <b>\$ 24,529</b>     |

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

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**B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

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

|  | Six months ended<br>June 30, |          | Year ended<br>December 31,<br>2006 |
|--|------------------------------|----------|------------------------------------|
|  | 2007                         | 2006     |                                    |
|  | (Unaudited)                  |          |                                    |
| Revenues   | \$ 11,072                    | \$ 9,559 | \$ 20,917                          |
| Cost of revenues                                   | 8,666                        | 7,240    | 16,200                             |
| Gross profit                                       | 2,406                        | 2,319    | 4,717                              |
| Operating costs and expenses:                      |                              |          |                                    |
| Research and development                           | 222                          | 289      | 486                                |
| Sales and marketing                                | 1,470                        | 996      | 2,019                              |
| General and administrative                         | 973                          | 1,534    | 3,268                              |
| Total operating costs and expenses                 | 2,665                        | 2,819    | 5,773                              |
| Operating loss                                     | (259)                        | (500)    | (1,056)                            |
| Financial expenses, net                            | (354)                        | (206)    | (626)                              |
| Expenses related to conversion of convertible note | (611)                        | -        | -                                  |
| Other income (expenses), net                       | 31                           | (39)     | -                                  |

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|   | Six months ended<br>June 30, |           | Year ended<br>December 31,<br>2006 |
|---|------------------------------|-----------|------------------------------------|
|   | 2007                         | 2006      | 2006                               |
| Loss before taxes on income                                     | (1,193)                      | (745)     | (1,682)                            |
| Tax benefit   | 43                           | 13        | 89                                 |
| Loss from continuing operations                                 | (1,150)                      | (732)     | (1,593)                            |
| Income related to discontinued operations                       | -                            | 906       | 1,685                              |
| Net income (loss)   | \$ (1,150)                   | \$ 174    | \$ 92                              |
| Basic and diluted net loss per share from continuing operations | \$ (0.15)                    | \$ (0.10) | \$ (0.24)                          |
| Diluted net earnings per share from discontinued operations     | -                            | \$ 0.13   | \$ 0.25                            |
| Basic and diluted net earnings (loss) per share                 | \$ (0.15)                    | \$ 0.03   | \$ 0.01                            |

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

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**B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**U.S. dollars in thousands Unaudited**

|  | Six months ended<br>June 30, |        | Year ended<br>December 31,<br>2006 |
|--|------------------------------|--------|------------------------------------|
|  | 2007                         | 2006   | 2006                               |
|  | (Unaudited)                  |        |                                    |
| <b>Cash flows from operating activities:</b>   |                              |        |                                    |
| Net income (loss)  | \$ (1,150)                   | \$ 174 | \$ 92                              |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: |                              |        |                                    |
| Loss (income) from discontinued operations (see Note 1b)                             | -                            | (906)  | (1,685)                            |
| Depreciation and amortization  | 158                          | 200    | 378                                |
| Increase (decrease) in accrued severance pay, net                                    | (44)                         | (87)   | (75)                               |
| Impairment of investment in company  | -                            | 39     | 39                                 |
| Stock-based compensation to employees and directors                                  | 288                          | 143    | 431                                |
| Stock-based compensation related to warrants issued to service providers             | -                            | 262    | 296                                |
| Expenses related to conversion of convertible note                                   | 611                          | -      | -                                  |
| Amortization of issuance expenses in connection with long-term convertible note      | 99                           | 51     | 162                                |
| Decrease (increase) in trade receivables   | 132                          | 379    | (788)                              |
| Increase in other accounts receivable and prepaid expenses                           | (285)                        | (131)  | (595)                              |
| Decrease (increase) in inventories   | (553)                        | 67     | (697)                              |
| Increase (decrease) in trade payables  | (1,109)                      | (935)  | 790                                |

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|   | Six months ended<br>June 30, |         | Year ended<br>December 31,<br>2006 |
|---|------------------------------|---------|------------------------------------|
|   | 2007                         | 2006    | 2006                               |
| Decrease in employees and payroll accruals, deferred revenues, accrued expenses and other liabilities | (223)                        | (546)   | (231)                              |
| Decrease in deferred taxes  | (15)                         | (33)    | (70)                               |
| Net cash used in operating activities from continuing operations                                      | (2,091)                      | (1,323) | (1,953)                            |
| Net cash used in operating activities from discontinued operations                                    | -                            | (79)    | (446)                              |
| Net cash used in operating activities   | (2,091)                      | (1,402) | (2,399)                            |
| <b>Cash flows from investing activities:</b>  |                              |         |                                    |
| Purchase of property, plant and equipment   | (97)                         | (24)    | (24)                               |
| Investment in other companies   | (15)                         | (376)   | (676)                              |
| Proceeds from sale of marketable securities   | -                            | 1,327   | 1,331                              |
| Net cash (used in) provided by investing activities from continuing operations                        | (112)                        | 927     | 631                                |
| Net cash used in investing activities from discontinued operations                                    | -                            | (221)   | (221)                              |
| Net cash provided by (used in) investing activities   | (112)                        | 706     | 410                                |

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

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**B.O.S. BETTER ONLINE SOLUTIONS LTD.  
AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**U.S. dollars in thousands**

|  | Six months ended<br>June 30, |      | Year ended<br>December 31, |
|--|------------------------------|------|----------------------------|
|  | 2007                         | 2006 | 2006                       |
|  | (Unaudited)                  |      |                            |
| <b>Cash flows from financing activities:</b>                       |                              |      |                            |
| Repayment of short-term and long-term bank loans                   | (533)                        | (15) | (26)                       |
| Proceeds from long-term bank loans                                 | 1,441                        | -    | -                          |
| Proceeds from short-term bank loans                                | 539                          | 884  | 686                        |
| Proceeds from issuance of shares and exercise of options, net      | 4,690                        | 54   | 135                        |
| Proceeds from long-term convertible note, net of issuance expenses | -                            | (13) | 1,319                      |
| Payment of long-term convertible note                              | (351)                        | (90) | (438)                      |



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|   | Six months ended<br>June 30, |          | Year ended<br>December 31,<br>2006 |
|---|------------------------------|----------|------------------------------------|
| Net cash provided by financing activities                                 | 5,786                        | 820      | 1,676                              |
| Increase (decrease) in cash and cash equivalents                          | 3,583                        | 124      | (313)                              |
| Increase in cash and cash equivalents of discontinued operations          | -                            | 114      | 114                                |
| Cash and cash equivalents at the beginning of the period                  | 2,033                        | 2,232    | 2,232                              |
| Cash and cash equivalents at the end of the period                        | \$ 5,616                     | \$ 2,470 | \$ 2,033                           |
| <b>Supplemental disclosure of cash flow activities:</b>                   |                              |          |                                    |
| <b>(a) Non-cash activities:</b>   |                              |          |                                    |
| Conversion of convertible note into shares                                | \$ 1,897                     | \$ -     | \$ -                               |
| Sales of the communication segment in consideration for shares in Qualmax | -                            | 958      | \$ 958                             |
| Conversion of Qualmax's debt into New World Brand's shares                | \$ -                         | \$ -     | \$ 1,480                           |
| <b>(b) Net cash paid during the period for</b>                            |                              |          |                                    |
| Interest  | \$ 303                       | \$ 173   | \$ 532                             |
| Income tax  | \$ 32                        | \$ 59    | \$ 180                             |

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

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**B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 1: GENERAL**

- a. B.O.S. Better Online Solutions Ltd. (together with its subsidiaries the Company), manages its business in two reportable segments, which consist of Software Solutions and the Supply-Chain Solutions. A third segment, Communication Solutions, existed until it was sold in the fourth quarter of 2005 (see b).

The Company's wholly owned subsidiaries include:

In Israel:

(1) BOScom Ltd.;

(2) Odem, which we purchased on November 18, 2004 from Odem's previous shareholders, and in which, by November 2005, our holdings increased to 100%. Odem, an Israeli company, is a major solution provider and distributor of RFID and electronics

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components and advance technologies in the Israeli market; and

(3) Quasar Telecom (2004) Ltd.. The assets of Quasar Telecom were sold as part of the sale of the Communications Segment in the fourth quarter of 2005.

In the U.S.:

(1) Ruby-Tech Inc., a wholly owned subsidiary of Odem;

(2) Lynk USA Inc., a subsidiary of BOS, and its subsidiary PacInfo (both Delaware corporations) and PacInfo's subsidiary, Dean Tech Technologies Associates, LLC., a Texan corporation; and

(3) BOS Delaware Inc. a Delaware corporation.

In the U.S., only Ruby-Tech is still operational.

In Europe BOScom had a UK subsidiary, Better On-Line Solutions Ltd., and its subsidiary, Better On-Line Solutions S.A.S in France. Since mid-2003 the operations of all the company in Europe were ceased.

In addition, the Company holds shares in two other companies:

1. Surf Communication Systems Ltd. ( Surf ), a developer and supplier of access and network convergence software solutions to the wire line and wireless telecommunications and data communications industries. The Company holds 7.8% of Surf's issued and outstanding shares (see Note 6).
2. Qualmax Inc. ( Qualmax ), a U.S. public corporation listed on the Pink Sheets ( QMXI.PK ), and its subsidiaries New World Brands Inc. (OTC: NWBD.OB) and IPGear. Qualmax and its subsidiaries are developers and suppliers of voiceover IP technology products and services. The Company holds 18% of the issued and outstanding shares of Qualmax Inc. and holds 3.9% of the issued and outstanding shares of New World Brands Inc.. The Company's holdings in Qualmax were received as the consideration for the sale of its communication segment (see Note 6).

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### B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES

#### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 1: GENERAL (Cont.)**

b. Discontinued operations:

1. Sale of communication segment:

On December 31, 2005, the Company sold its communication segment, including its property and equipment, goodwill, technology, trade name, existing distribution channels and related contingent liability to the Office of the Chief Scientist to IP Gear Ltd. ( IP Gear ), a wholly owned Israeli subsidiary of Qualmax. The consideration paid to the Company in the transaction was approximately 3.2 million Qualmax shares of Common stock constituting approximately 16% of Qualmax's total issued and outstanding Common stock and \$800 in royalties to be paid at a rate of 4% from future revenues IP Gear will generate from the disposed segment ( Royalties ) with the entire \$800 due no later than 90 days from the third anniversary of the closing of the transaction. Additional shares could be issued to the Company at the end of four consecutive fiscal quarters following the closing of the transaction, contingent upon IP Gear generating by then a certain level of revenues from the disposed segment ( Earn Out Shares ). The maximum number of Earn Out Shares could have

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further been issued to the Company is approximately 1 million, constituting an additional 5% of Qualmax outstanding shares. In June 2006, the Company received 250,000 of Qualmax shares, valued at \$1.43 per share, as part of the Earn Out Shares consideration.

The Company received certain piggy-back registration rights with respect to the Qualmax shares. The Company does not have a representative on the Board of Qualmax.

In addition, the Company and IP Gear entered into an Outsourcing Agreement, pursuant to which the Company provided IP Gear with certain operating services relating to the sold communication segment through December 31, 2006. In accordance with the Outsourcing Agreement, the first three months of services were provided for no charge. For services rendered from April 2006 through December 2006, the Company charged IP Gear \$240, which was paid by issuing the Company Qualmax subsidiary's shares in December 2006, as part of an agreement signed by the parties (see below).

The Company also granted a bridge loan to IP Gear in the amount of \$1,000. The term of the loan is three years and it bears interest equal to the Prime rate plus 2.5%, up to a maximum of 12%. In the first 18 months, IP Gear shall pay only the interest accrued on the loan and monthly principal and interest payments shall commence thereafter. The loan granted to IP Gear is secured by a first priority floating charge, which may be subordinated to a charge in favor of a major financial institution in the event such charge is recorded. In addition, repayment is guaranteed by Qualmax Inc.

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### B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES

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#### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 1: GENERAL (Cont.)**

The loan agreement provides that if the disposed segment would incur in the first quarter of 2006, losses that exceed \$250, the principal amount to be repaid under the loan shall be reduced by the excess losses. In such event, Qualmax shall issue to the Company additional shares of Common stock against such reduction, valued at a predetermined price of \$1.43 per share. Pursuant to this provision, in May 2006, Qualmax issued to the Company 244,755 shares, at a price of \$1.43 per share, resulting in an amount of \$350. In June 2006, Qualmax issued BOS an additional 174,825 shares, reducing the principal amount of the loan to \$400 following which, the Company holds approximately 17.8% of Qualmax's total issued and outstanding Common stock. As part of the agreement signed between the parties in December 2006, the loan was fully repaid by issuance of additional shares of Qualmax (see below).

Qualmax also issued to the Company a five-year warrant for the purchase of up to 107,143 shares, constituting less than 1% of its outstanding shares in Qualmax, at the exercise price of \$2.80 per share ( Warrants ). The Company received certain piggy-back registration rights with respect to the shares underlying the warrants.

The Company signed in December 2006 an agreement with Qualmax and its subsidiaries, New World Brands Inc. ( NWB ) and IP Gear, pursuant to which, the outstanding debt of Qualmax to the Company, in the amount of \$1,480 (which included long-term debt, outsourcing fees, royalties and other debts), was repaid to the Company through the issuance of 5,506,652 shares of series A Convertible Preferred stock of NWB which are convertible into approximately 16,450,000 shares of NWB Common stock. On April 24, 2007 series A Preferred stock converted into Common stock. As of June 30, 2007, the Company holds 18% in Qualmax and 3.9% in NWB. The Company's registration rights with respect to the Qualmax shares also apply to NWB shares.

In connection with the transaction, the Company agreed to grant NWB, contingent upon the satisfaction of certain conditions, a three-year option to purchase up to 30% of the NWB's shares held by the Company, at prices ranging from \$0.12 to \$0.24 per share of Common stock.

In addition, the Company agreed to enter into a lock up agreement, restricting the transfer of the share holdings in Qualmax and in NWB, for up to two years.

The Company accounts for its holdings in Qualmax shares on the cost basis since it is unable to exercise significant influence over Qualmax financial policies and since the shares held in Qualmax are restricted stock which do not meet the fair value availability criteria of FAS 115.

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**B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 1: GENERAL (Cont.)**

For the six months ended June 30, 2006 and for the year ended December 31, 2006 the Company's consolidated financial statements reflected a capital gain from the sale of the communication segment, which was determined as follows:

|   | <b>Six months<br/>ended<br/>June 30, 2006</b> | <b>Year ended<br/>December<br/>31, 2006</b> |
|---|---|---|
|   | <b>(Unaudited)</b>                            |   |
| <b>Consideration:</b>   |   |   |
| Ordinary shares of Qualmax (1)  | \$ 957  | \$ 957                                      |
| 5.50652 series A Preferred stock of NWB (2)                           | -   | 1,480                                       |
| Royalties   | 51  | -   |
|   | 1,008   | 2,437                                       |
| <b>Cost:</b>  |   |   |
| Expenses  | 102   | -   |
| Disposal of assets (liabilities) related to the communication segment | -   | 752   |
|   | 102   | 752   |
| <b>Capital gain</b>   | <b>\$ 906</b>                                 | <b>\$ 1,685</b>                             |

(1) Valuated at \$1.43 per share.

(2) 5.50652 series A Preferred stock convertible into 16.5 million Common stock of NWB. Each Common stock is valuated at \$0.09 per share.

Following the agreement, signed in December 2006, the Company has accounted for the communication segment as a discontinued operation, in accordance with EITF 03-13 "Applying the Conditions in Paragraph 42 of FASB Statement 144 in Determining Whether to Report Discontinued Operations". As such, the results of operations, including revenues, cost of revenues, operating expenses, and other income and expenses of the communication segment for 2006 have been reclassified in the accompanying statements of operations as discontinued operations.

The results of operations, including revenues, cost of revenues, operating expenses and other income and expenses of the communication segment and PacInfo's operations for 2006 have been reclassified in the statements of operations. Taxes were not attributed to the discontinued operations due to utilization of losses from previous years, for which a valuation allowance was provided.

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**B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 1: GENERAL (Cont.)**

Summarized selected financial information and cash flows of the discontinued operations are as follows:

|  | Six months ended<br>June 30, 2006 | Year ended<br>December 31,<br>2006 |
|--|-----------------------------------|------------------------------------|
|  | (Unaudited)                       |                                    |
| <u>Cash flows from operating activities</u>        |                                   |                                    |
| Gain from discontinued operations                  | \$ 906                            | \$ 1,685                           |
| Capital gain                                       | (906)                             | (2,052)                            |
| Adjustments due to changes in working capital      | (79)                              | (79)                               |
| <u>Net cash flows used in operating activities</u> | <u>\$ (79)</u>                    | <u>\$ (446)</u>                    |
| <u>Cash flows from investing activities</u>        |                                   |                                    |
| Communication sales costs                          | \$ (221)                          | \$ (221)                           |
| <u>Net cash flows used in investing activities</u> | <u>\$ (221)</u>                   | <u>\$ (221)</u>                    |

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES**

- a. The significant accounting policies followed in the preparation of these financial statements are identical to those applied in the preparation of the latest annual financial statements except as detailed in below.
- b. Recently issued accounting pronouncements:

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis that is more-likely-than-not to be realized upon ultimate

settlement.

FIN 48 applies to all tax positions related to income taxes subject to the Financial Accounting Standard Board Statement No. 109, Accounting for Income Taxes ( SFAS 109 ). This includes tax positions considered to be routine as well as those with a high degree of uncertainty.

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**B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

FIN 48 has expanded disclosure requirements, which include a tabular roll-forward of the beginning and ending aggregate unrecognized tax benefits as well as specific details related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. These disclosures are required at each annual reporting period unless a significant change occurs in an interim period.

FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect of applying FIN 48 will be reported as an adjustment to the opening balance of retained earnings. The Company has adopted FIN 48 commencing January 1, 2007 and it has no effect on its financial position and results of operations.

**NOTE 3: UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States for interim financial information. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

**NOTE 4: INVENTORIES**

|   | <b>June<br/>30, 2007</b> | <b>December 31,<br/>2006</b> |
|---|--------------------------|------------------------------|
|   | <b>(Unaudited)</b>       |                              |
| Raw materials (including packaging materials) | \$ 109                   | \$ 120                       |
| Finished products                             | 4,461                    | 3,897                        |
|   | <b>\$ 4,570</b>          | <b>\$ 4,017</b>              |

The inventories are presented net of provision for technological obsolescence and slow-moving items of \$ 87 and \$ 100 as of June 30, 2007 and December 31, 2006, respectively.

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## B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 5: CUSTOMER LIST, NET

|                          | June<br>30, 2007 | December 31,<br>2006 |
|--------------------------|------------------|----------------------|
|                          | (Unaudited)      |                      |
| Cost                     | \$ 2,010         | \$ 2,010             |
| Accumulated amortization | 483              | 381                  |
| Amortized cost           | \$ 1,527         | \$ 1,629             |

Amortization expenses with respect to the customer list amounted to \$ 102 and \$ 207 for the six months ended June 30, 2007 and for year ended December 31, 2006, respectively.

Amortization expenses for the years ended December 31:

|            |        |
|------------|--------|
| 2007       | \$ 207 |
| 2008       | \$ 207 |
| 2009       | \$ 207 |
| 2010       | \$ 207 |
| 2011- 2013 | \$ 699 |

## NOTE 6: INVESTMENT IN OTHER COMPANIES

The Company's investments in companies comprise of:

|                                     | June 30,<br>2007 | December 31,<br>2006 |
|-------------------------------------|------------------|----------------------|
|                                     | (Unaudited)      |                      |
| Surf Communication Systems Ltd.     | \$ 983           | \$ 983               |
| Qualmax Inc. (see note 1b)          | 5,619            | 5,619                |
| New World Brands Inc. (see note 1b) | 1,480            | 1,480                |
|                                     | \$ 8,082         | \$ 8,082             |

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**B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 6: INVESTMENT IN OTHER COMPANIES (Cont.)**

Investment in Surf Communication Systems Ltd.:

During the years 2001 through 2005 the company participated in several investment rounds in Surf. In June 2006, as part of the investment round, the Company invested \$300 in Surf, following which, the Company holds 7.8% of Surf's issued and outstanding shares. The investment is accounted for based on the cost accounting method.

**NOTE 7: LONG-TERM CONVERTIBLE NOTE**

In September 2005, the Company entered into a Securities Purchase Agreement (the Purchase Agreement) with Laurus Master Fund (Laurus), an a U.S. based fund making investments in public companies, under which the Company issued to Laurus in a private placement (i) a Secured Convertible Term Note of a \$ 1,500 principal amount, due September 2008 (the Note), and (ii) a warrant to purchase 73,052 Ordinary shares at an exercise price of \$ 4.04 per share (the Warrant). According to the agreement, several fees in the total amount of \$ 116 were paid to the investor. These fees are presented as a discount of the principal convertible loan. The Note is convertible into Ordinary shares at a price of \$ 3.08 per share. The principal amount of the Note is repayable in monthly installments, commencing as of January 2006, in the initial amount of \$ 15 eventually increasing to \$ 55. The Note bears Prime interest rate plus 1.5% which is subject to reduction under certain conditions. The Warrant is exercisable, in whole or in part, until September 29, 2012.

The fair value of the Warrants was calculated using the Black-Scholes option pricing model with the following assumptions: a risk-free interest rate of 4.08%, a dividend yield of 0%, a volatility of the expected market price of the Company's Ordinary shares of 100% and a weighted-average contractual life of seven years. The fair value of the Warrants in the amount of \$ 144 is offset against the Note, amortized over the period of the Note and presented as a component in shareholders' equity.

On August 17, 2006, the Company entered into an additional financing transaction with Laurus. The third financing consisted of a \$ 1.5 million Secured Convertible Term Note with a term of three years. In addition, the Company granted to Laurus a warrant to purchase up to 73,052 Ordinary shares, which is exercisable, in whole or in part, until August 16, 2013 at an exercise price of \$ 4.04 per share for the first 24,351 Ordinary shares acquirable there under and of \$ 5.30 per share for the additional 48,701 shares acquirable hereunder. The fair value of the warrants was calculated using the Black-Scholes option pricing model with the following assumptions: a risk-free interest rate of 4.83%, a dividend yield of 0%, a volatility of the expected market price of the Company's Ordinary shares of 81% and a weighted-average contractual life of seven years. The fair value of the warrants in the amount of \$ 131 is offset against the Note, amortized over the period of the Note and presented as a component in shareholders' equity. The Note bears interest which begins at the Prime rate plus 1.5%.

The conversion rate under the Note is \$ 3.08 per share for the first \$ 500 of the principal amount payable there under and \$ 4.08 for any additional amount payable there under (subject to adjustment). The principal amount of the Note is repayable in monthly installments commencing as of December 1, 2006, and may be paid in cash or, subject to certain conditions, in Ordinary shares. Interest on the Note is payable monthly and may be paid in cash or, subject to certain conditions, in Ordinary shares. The Note is secured by a security interest in certain assets of the Company.

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**B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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



**NOTE 7: LONG-TERM CONVERTIBLE NOTE (Cont.)**

The registration statement filed in this respect became effective on December 6, 2006.

On June 21, 2007, the company reduced the conversion price of the Note to \$2.53 and Laurus converted the entire outstanding principal amount under the Notes, of approximately \$ 2,223,000, into 878,670 Ordinary Shares of the company. As a result the Company recorded expenses of \$611 in the first six months of year 2007.

The maturity of the loan is as follows:

|                                 | <u>June 30,</u><br><u>2007</u> | <u>December 31,</u><br><u>2006</u> |
|---------------------------------|--------------------------------|------------------------------------|
|                                 | <u>(Unaudited)</u>             |                                    |
| First year (current maturities) | \$ -                           | \$ 1,139                           |
| Second year                     | -                              | 1,104                              |
| Third year                      | -                              | 331                                |
|                                 | <u>-</u>                       | <u>2,574</u>                       |
| Less - discount                 | -                              | 264                                |
|                                 | <u>\$ -</u>                    | <u>\$ 2,310</u>                    |

**NOTE 8: COMMITMENTS AND CONTINGENT LIABILITIES**

a. Legal proceedings:

In March 2005, BOSÂNOVA EURL, a French company and former distributor of the Company, filed against the Company and others a claim with the French Tribunal, in the amount of 1.4 million Euros, alleging breach of exclusive distributor rights in France. This claim follows a previous motion for temporary injunctive relief that was filed against the Company's new French distributor, said motion ultimately denied by French Trade Tribunal. The Company's financial statements include a provision in this respect.

In 1998, as part of PacInfo Share Purchase Agreement between the Company and Mr. Lee and Ms. Lee ( the Sellers ), the Company may be obligated to grant the Sellers a loan on a full recourse basis for certain tax payments the Sellers may be liable for and reimburse the Sellers for certain interest on taxes that they may owe, currently estimated at approximately \$2 million. The Company will receive a security interest in shares of the Company that the Sellers holds at the time of the loan with a fair market value as of the date of the loan of at least 125% of the amount of the loan as security for the repayment of the loan. It is possible that the windup of PacInfo during 2002 and 2003 may have triggered such a tax event for the Sellers, which would result in an obligation by the Company to lend the Sellers such amount and to reimburse them for interest expenses incidental to the tax event. Based on the Company's legal counsel opinion and management estimation, no provision was recorded.

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b. Other commitments:

The facilities of the Company are rented under lease agreements that expire on various dates ending in 2012. Minimum future rental payments are as follows:

**Period:**

|           |    |    |
|-----------|----|----|
| 7-12/2007 | \$ | 53 |
| 2008      |    | 64 |
| 2009      |    | 58 |
| 2010      |    | 46 |
| 2011      |    | 45 |
| 2012      |    | 4  |

The Company's motor vehicles are rented under various cancelable operating lease agreements. The lease agreements for the motor vehicles expire on various dates ending in 2010. The maximum breach of contract fees can amount to \$ 39.

Lease payments for the facilities occupied by the Company and the Company's motor vehicles in the first six months of 2007 and 2006 amounted to \$ 197 and \$ 408, respectively.

As of June 30, 2006, Odem has bank guarantees in the amount of \$ 271 in favor of certain third parties.

### NOTE 9: SHAREHOLDERS EQUITY

In March 25, 2007 the company granted to its employee 627,000 options in exercise price of \$2.52 per share. The options shall vest and become exercisable in 4 equal annual installments with the first installment vesting upon the lapse of a year from grant.

In April 2007 the Company completed rights offering in which it issued 1,739,398 ordinary shares at a share price of \$2.5. The gross proceeds amounted to \$4.4 million.

On June 21, 2007 B.O.S. Laurus Master Fund Ltd., converted the entire outstanding principal amount under the Notes, of approximately \$ 2,223,000, into 878,670 Ordinary Shares of BOS.

On June 26, 2007 BOS entered into a definitive private placement agreement with a European private investor for the issuance of 226,415 Ordinary Shares at a price per share of \$2.65.

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## B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

### NOTE 9: SHAREHOLDERS EQUITY (Cont.)

The Company's outstanding warrants to shareholders as of June 30, 2007 are as follows:

| Issuance date | Warrants for<br>Ordinary shares | Exercise price<br>per share | Warrants<br>exercisable | Exercisable through |
|---------------|---------------------------------|-----------------------------|-------------------------|---------------------|
| June 2005     | 441,785                         | \$ *) 2.75                  | 441,785                 | June 2008           |
| July 2005     | 130,434                         | \$ *) 2.75                  | 130,434                 | June 2008           |

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| Issuance date | Warrants for<br>Ordinary shares | Exercise price<br>per share | Warrants<br>exercisable | Exercisable through |
|---------------|---------------------------------|-----------------------------|-------------------------|---------------------|
|               | 572,219                         |                             | 572,219                 |                     |

(\*) The exercise price of the warrants will increase to \$ 3.03 per Ordinary share, on July 2007

A summary of employee option activity under the Company's stock option plans as of June 30, 2007 and changes during the six months ended June 30, 2007 are as follows:

|  | Number<br>of options | Weighted average<br>exercise price |
|--|----------------------|------------------------------------|
| Options outstanding at beginning of period   | 822,660              | \$ 3.36                            |
| Changes during the period:                   |                      |                                    |
| Granted                                      | 627,000              | \$ 2.52                            |
| Exercised                                    | (8,239)              | \$ 2.00                            |
| Forfeited or cancelled                       | (42,425)             | \$ 15.16                           |
| Options outstanding at the end of the period | 1,398,996            | \$ 2.63                            |
| Options exercisable at the end of the period | 287,749              | \$ 3.48                            |

The weighted-average grant-date fair value of options granted during the six months ended June 30, 2007 and during the year ended December 31, 2006 was \$ 2.57 and \$ 1.45, respectively. As of June 30, 2007, there was \$ 1,321 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted to employees and directors under the Company's stock option plans. That cost is expected to be recognized over a weighted-average period of 1.7 years.

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**B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 9: SHAREHOLDERS' EQUITY (Cont.)**

The fair value of the Company's stock options granted to employees and directors for the six months ended June 30, 2007 was estimated using the following weighted average assumptions:

|                    | Six months ended<br>June 30, 2007 |
|--------------------|-----------------------------------|
|                    | (Unaudited)                       |
| Risk free interest | 5.03%                             |
| Dividend yields    | 0%                                |

Six months ended  
June 30, 2007

|                          |     |
|--------------------------|-----|
| Volatility               | 60% |
| Expected term (in years) | 4   |

The options granted to employees outstanding as of June 30, 2007 have been separated into ranges of exercise prices, as follows:

| Range of exercise price | Options outstanding as of June 30, 2007 | Weighted average exercise price | Weighted average remaining contractual life (years) | Options exercisable as of June 30, 2007 | Weighted average exercise price of options exercisable |
|-------------------------|---|---------------------------------|---|---|--|
| \$ 0                    | 73,000                                  | \$ 0.00                         | 7.39  | -                                       | \$ 0.00  |
| \$ 1.84-2.00            | 59,722                                  | \$ 1.88                         | 2.43  | 59,722                                  | \$ 1.88  |
| \$ 2.28-3               | 1,247,237                               | \$ 2.61                         | 7.18  | 208,990                                 | \$ 2.74  |
| \$ 6.8                  | 9,937                                   | \$ 6.80                         | 2.31  | 9,937                                   | \$ 6.80  |
| \$ 18.00                | 600                                     | \$ 18.00                        | 2.37  | 600                                     | \$ 18.00   |
| \$ 28.00                | 8,500                                   | \$ 28.00                        | 1.77  | 8,500                                   | \$ 28.00   |
|                         | <u>1,398,996</u>                        | <u>\$ 2.63</u>                  | <u>2.91</u>   | <u>287,749</u>                          | <u>\$ 3.48</u>   |

Options issued to service providers:

The Company accounts for these options in accordance with the provisions of SFAS 123 and EITF 96-18. There were no grants of options to service providers during the six months ended June 30, 2007. The fair value for these options was estimated at the date of grant using Black-Scholes option pricing model with the following assumptions for the 6 months ended June 2006 and the year ended December 31, 2006: risk-free interest rate of 4.8%, and 4.9%, respectively, dividend yields of 0% and 0%, respectively, volatility of 76% and 77%, respectively, and an expected life of 2.6 years and 2.6 years, respectively

The compensation expenses that have been recorded in the consolidated financial statements regarding these warrants for the six months ended June 30, 2007 and for the year ended December 31, 2006 were \$ 1 and \$ 116, respectively.

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## B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 9: SHAREHOLDERS EQUITY (Cont.)

The Company's outstanding options to service providers as of June 30, 2007 are as follows:

| Issuance date | Options for Ordinary shares | Exercise price per share | Options exercisable | Exercisable through |
|---------------|-----------------------------|--------------------------|---------------------|---------------------|
| October 2002  | 75,000                      | \$ 4.00                  | 75,000              | December 2008       |
| June 2004     | 130,000                     | \$ 4.04                  | 130,000             | June 2011           |

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| Issuance date  | Options for Ordinary shares | Exercise price per share | Options exercisable | Exercisable through |
|----------------|-----------------------------|--------------------------|---------------------|---------------------|
| March 2005     | 10,000                      | \$ 3.08                  | 3,334               | March 2010          |
| September 2005 | 73,052                      | \$ 4.04                  | 73,052              | September 2012      |
| March 2006     | 10,000                      | \$ 2.30                  | 10,000              | December 2008       |
| August 2006    | 48,701                      | \$ 5.30                  | 48,701              | August 2013         |
| August 2006    | 24,351                      | \$ 4.04                  | 24,351              | August 2013         |
|                | 371,104                     |                          | 364,438             |                     |

**NOTE 10: SEGMENTS AND GEOGRAPHICAL INFORMATION**

The Company manages its business in two reportable segments, which consist of software solutions and supply chain solutions.

The Company's management makes financial decisions and allocates resources, based on the information it receives from its internal management system. The Company allocates resources and assesses performance for each operating segment using information about revenues, gross profit and operating income (loss) before interest and taxes.

- a. Revenues, gross profit and operating income (loss) for operating segments for the six months ended June 30, 2007 and 2006 and for the year ended December 31, 2006 were as follows:

|                           | Six months ended June 30, 2007 |                        |               |              |
|---------------------------|--------------------------------|------------------------|---------------|--------------|
|                           | Software Solutions             | Supply Chain Solutions | Not allocated | Consolidated |
|                           | (Unaudited)                    |                        |               |              |
| Revenues                  | \$ 824                         | \$ 10,248              | \$ -          | \$ 11,072    |
| Gross profit              | \$ 647                         | \$ 1,759               | \$ -          | \$ 2,406     |
| Operating income (loss)   | \$ 147                         | \$ 290                 | \$ (696)      | \$ (259)     |
| Assets related to segment | \$ 252                         | \$ 14,431              | \$ 13,718     | \$ 28,401    |

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**B.O.S. BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 10: SEGMENTS AND GEOGRAPHICAL INFORMATION (Cont.)**

|  | Six months ended June 30, 2006 |                        |               |              |
|--|--------------------------------|------------------------|---------------|--------------|
|  | Software Solutions             | Supply Chain Solutions | Not allocated | Consolidated |

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| Six months ended June 30, 2006 |          |           |          |           |
|--------------------------------|----------|-----------|----------|-----------|
| (Unaudited)                    |          |           |          |           |
| Revenues                       | \$ 1,018 | \$ 8,541  | \$ -     | \$ 9,559  |
| Gross profit                   | \$ 665   | \$ 1,654  | \$ -     | \$ 2,319  |
| Operating income (loss)        | \$ (71)  | \$ 102    | \$ (531) | \$ (500)  |
| Assets related to segment      | \$ 1,786 | \$ 11,780 | \$ 7,938 | \$ 21,504 |

  

| Year ended December 31, 2006 |                    |                        |               |              |
|------------------------------|--------------------|------------------------|---------------|--------------|
|                              | Software Solutions | Supply Chain Solutions | Not allocated | Consolidated |
| Revenues                     | \$ 2,058           | \$ 18,859              | \$ -          | \$ 20,917    |
| Gross profit                 | \$ 1,341           | \$ 3,376               | \$ -          | \$ 4,717     |
| Operating income (loss)      | \$ (35)            | \$ (64)                | \$ (957)      | \$ (1,056)   |
| Assets related to segment    | \$ 243             | \$ 13,700              | \$ 10,586     | \$ 24,529    |

- b. The following presents total revenues and long-lived assets for the six months ended June 30, 2007 and 2006 and for the year ended December 31, 2006 in accordance with Statement of Financial Accounting No. 131, Disclosures about Segments of an Enterprise and Related Information ( SFAS 131 ):

|                  | Six months ended<br>June 30, |          | Year ended<br>December 31,<br>2006 |
|------------------|------------------------------|----------|------------------------------------|
|                  | 2007                         | 2006     |                                    |
| (Unaudited)      |                              |          |                                    |
| Revenues:        |                              |          |                                    |
| United States    | \$ 1,928                     | \$ 1,087 | \$ 2,848                           |
| Far-East         | 554                          | 1,253    | 2,019                              |
| Europe           | 966                          | 447      | 1,173                              |
| Israel and other | 7,624                        | 6,772    | 14,877                             |
|                  | \$ 11,072                    | \$ 9,559 | \$ 20,917                          |

All the long-lived assets are attributed to Israel's geographic area, and are comprised of goodwill, intangible assets, property, plant and equipment.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 10: SEGMENTS AND GEOGRAPHICAL INFORMATION (Cont.)

- c. Major customer data as a percentage of total revenues:

|            | Six months ended<br>June 30, |      | Year ended<br>December 31, |
|------------|------------------------------|------|----------------------------|
|            | 2007                         | 2006 | 2006                       |
|            | Unaudited                    |      |                            |
| Customer A | 27%                          | 20%  | 24%                        |

Major customers debt balances as of June 30, 2007 and December 31, 2006 are \$ 1,869 and \$ 1,971, respectively.

## NOTE 11: SUBSEQUENT EVENTS

The general meeting of shareholders that held on August 9, 2007, adopted, as the following resolutions:

- reelect Messrs. Edouard Cukierman, Joel Adler and Ronen Zavlik and to elect Messrs. Amir Ohad, Joshua Zoller and Dan Hoz to the Company's Board of Directors, to serve until the next annual general meeting of shareholders and until their successors have been duly elected and qualified.
- reappoint Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young International, Ltd. as the Company's Independent Auditors.
- approve an increase of options available for issuance under the Company's 2003 Israeli Share Option Plan to 2.6 million from 1.5 million.

Following this approval, 103,600 options were granted to officers at an exercise price of \$2.52 per share. The options shall vest and become exercisable in 4 equal annual installments with the first installment vesting upon the lapse of a year from March 25, 2007.