TAT TECHNOLOGIES LTD
Form 20-F
July 02, 2007

# SECURITIES AND EXCHANGE COMMISSION

**Washington D.C. 20549**

# FORM 20-F

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2006**

**OR**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from _____________ to ____________**

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Date of event requiring this shell company report ..

**Commission file number: 0-16050**

# TAT TECHNOLOGIES LTD.

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

**Israel**
(Jurisdiction of incorporation or organization)

**P.O. Box 80, Gedera 70750, Israel**
(Address of principal executive offices)

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| **Ordinary Shares, NIS 0.90 Par Value** | **NASDAQ Capital Market** |

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

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

| | |
|---|---|
| **Ordinary Shares, par value NIS 0.00 per share** | **6,042,671** |

(as of December 31, 2006)

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

Yes o No x

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

Yes o No x

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

Yes x No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

Item 17 o Item 18 x

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

Yes o No x

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**INTRODUCTION**

TAT Technologies Ltd. is engaged in the manufacture and sale of a broad range of heat transfer components used in mechanical and electronic systems on board commercial and military aircraft and in a variety of other electronic equipment. We also provide maintenance, repair and overhaul, or MRO, services and parts supply services to the aerospace industry. Our four FAA certified repair stations in Oklahoma and North Carolina provide aircraft component MRO services for airlines, air cargo carriers, maintenance service centers and the military. We specialize in MRO services for components of aircraft, such as heat transfer components, auxiliary power units, or APUs, propellers, landing gear and pneumatic ducting. Our parts services division offers inventory management and parts services for commercial, regional and charter airlines and business aircraft owners.

We were incorporated under the laws of the State of Israel in April 1985 to develop the computerized systems business of our parent company, TAT Industries Ltd., or TAT Industries, a publicly held Israeli corporation engaged in the manufacture and sale of aeronautical equipment. In December 1991, we acquired the heat exchanger operations of TAT Industries and in February 2000, we entered into an agreement to purchase its operations relating to the manufacture of aviation accessories and to lease certain of its properties. We conduct business in the United States through our wholly owned subsidiary Limco-Piedmont Inc., a Delaware corporation, or Limco-Piedmont, and its subsidiaries, Limco Airepair Inc., or Limco, a Tulsa, Oklahoma based corporation and Piedmont Aviation Component Services, LLC, or Piedmont, a Kernersville, North Carolina based company. In July, 2005, we purchased Piedmont, which is engaged in the repair and overhaul of various aircraft accessories and in the provision of parts services.

From our initial public offering in March 1987 until July 1998, our ordinary shares were listed on the NASDAQ National Market (symbol: TATTF). In July 1998, the listing of our ordinary shares was transferred to the NASDAQ Capital Market and since August 2005, our shares have been also traded on the Tel Aviv Stock Exchange, or TASE. As used in this annual report, the terms we, us and our mean TAT Technologies Ltd. and its subsidiaries, unless otherwise indicated.

Except for the historical information contained in this annual report, the statements contained in this annual report are forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, with respect to our business, financial condition and results of operations. Such forward-looking statements reflect our current view with respect to future events and financial results.

Statements which use the terms anticipate, believe, do not believe, expect, plan, intend, estimate, anticipate and similar expre intended to identify forward-looking statements. We remind readers that forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors and involve known and unknown risks that could cause the actual results, performance, levels of activity, or our achievements, or industry results, to be materially different from any future results, performance, levels of activity, or our achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we undertake no obligation to publicly release any update or revision to any forward looking statements to reflect new information, future events or circumstances, or otherwise after the date hereof. We have attempted to identify significant uncertainties and other factors affecting forward-looking statements in the Risk Factors section that appears in Item 3. Key Information - Risk Factors.

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. All references in this annual report to dollars or $ are to U.S. dollars and all references in this annual report to NIS are to New Israeli Shekels.

Statements made in this annual report concerning the contents of any contract, agreement or other document are summaries of such contracts, agreements or documents and are not complete descriptions of all of their terms. If we filed any of these documents as an exhibit to this annual report or to any previous filing with the Securities and Exchange Commission, you may read the document itself for a complete recitation of its terms.

**PART I**

**Item 1. Identity of Directors, Senior Management and Advisers**

Not applicable.

**Item 2. Offer Statistics and Expected Timetable**

Not applicable.

**Item 3. Key Information**

**A. Selected Financial Data**

The following selected consolidated financial data for and as of the five years ended December 31, 2006 are derived from our audited consolidated financial statements which have been prepared in accordance with U.S. GAAP. The selected consolidated financial data as of December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004 have been derived from our audited consolidated financial statements and notes included elsewhere in this annual report. The selected consolidated financial data for the year ended December 31, 2005 include the results of operations of Piedmont as of July 1, 2005. The selected consolidated financial data as of December 31, 2004, 2003 and 2002 and for the years ended December 31, 2003 and 2002 have been derived from audited consolidated financial statements not included in this annual report. The selected consolidated financial data set forth below should be read in conjunction with and are qualified by reference to Item 5. Operating and Financial Review and Prospects and our consolidated financial statements and notes thereto included elsewhere in this annual report.

**Statement of Operations Data:**

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| | (in thousands, except per share data) | | | | |
| Revenues | | | | | |
| Sale of products | $ 33,709 | $ 21,460 | $ 19,138 | $ 18,223 | $ 15,637 |
| Services and other | 43,824 | 27,733 | 14,105 | 12,459 | 10,643 |
| Total revenues | $ 77,533 | $ 49,193 | $ 33,243 | $ 30,682 | $ 26,280 |
| Cost of revenues | | | | | |
| Sale of products | 25,425 | 14,078 | 11,559 | 11,054 | 9,759 |
| Services and other | 32,214 | 21,514 | 10,607 | 9,014 | 7.991 |
| Total cost of revenues | 57,639 | 35,592 | 22,166 | 20,068 | 17,750 |
| Gross profit | 19,894 | 13,601 | 11,077 | 10,614 | 8,530 |
| Operating expenses: | | | | | |
| Research and development costs, net | | 72 | 125 | 120 | 204 |
| Selling and marketing expenses | 3,466 | 2,495 | 1,894 | 1,958 | 1,483 |
| General and administrative expenses | 6,710 | 5,138 | 3,793 | 3,476 | 2,994 |
| Operating income | 9,718 | 5,896 | 5,265 | 5,060 | 3,849 |
| Financial income (expenses), net | (464) | (441) | 87 | (25) | 99 |
| Other income (loss), net | 59 | 210 | 54 | 24 | 8 |
| Income from operations before income taxes | 9,313 | 5,665 | 5,406 | 5,059 | 3,956 |
| Income taxes | 3,247 | 2,136 | 1,667 | 1,225 | 367 |
| Net income | $ 6,066 | $ 3,529 | $ 3,739 | $ 3,834 | $ 3,589 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Basic net earnings per share | $ | 1.00 | $ | 0.58 | $ | 0.72 | $ | 0.85 | $ | 0.80 |
| Diluted net income per share | $ | 0.98 | $ | 0.58 | $ | 0.67 | $ | 0.78 | $ | 0.77 |
| Weighted average number of shares used in computing basic net income per share | | 6,042 | | 6,042 | | 5,166 | | 4,510 | | 4,483 |
| Weighted average number of shares used in computing diluted net income per share | | 6,163 | | 6,087 | | 5,564 | | 4,907 | | 4,483 |
| Cash dividend per share | $ | 0.20 | $ | 0.18 | $ | 1.18 | $ | 0.70 | | |

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**Balance Sheet Data:**

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| | | | (in thousands) | | |
| Working capital | $ 29,743 | $ 30,387 | $ 26,623 | $ 22,336 | $ 19,685 |
| Total assets | 66,237 | 60,565 | 41,207 | 39,392 | 35,318 |
| Long-term debt, excluding current maturities | 8,283 | 13,786 | 4,054 | 3,793 | 3,362 |
| Shareholders equity | 39,720 | 34,861 | 32,526 | 28,684 | 25,419 |

**B. Capitalization and Indebtedness**

Not applicable.

**C. Reasonsfor the Offer and Use of Proceeds**

Not applicable.

**D. Risk Factors**

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

**Risks Related to Our Business and Our Industry**

***Our revenues and earnings depend substantially upon conditions in the airline industry, and a significant or prolonged downturn in the airline industry could decrease demand for our services and products.***

Our revenues are principally derived from the provision of MRO services to airlines, air cargo carriers, MRO service centers and the military; the manufacture of heat transfer components for use in civilian and military aircraft; and the provision of parts services for commercial, regional and charter airlines and business aircraft owners. Any downturn in the commercial aircraft industry could decrease demand for our services and products and negatively impact our financial condition. The commercial airline industry is cyclical and has historically been subject to fluctuations due to general economic and political conditions, such as fuel and labor costs, price competition, downturns in the global economy and national and international events.

In the aftermath of the September 11, 2001 terrorist attacks, passenger traffic on commercial flights was significantly lower than prior to the attacks. Most commercial airlines reduced their operating schedules, lowered fares and implemented cost reduction initiatives. In addition, war or armed hostilities or the fear of such events, could further exacerbate many of the problems experienced as a result of terrorist attacks. Future terrorist attacks, war or armed hostilities, the outbreak of SARS or other epidemic diseases such as avian influenza, or the fear of such events, could further negatively impact the airline industry. These factors, as well as increases in fuel costs, have resulted in large and, in some cases, continuing financial losses in the airline industry. Major carriers around the world have recently emerged from bankruptcy protection or are in the process of doing so. Financial losses and reduced schedules in the airline industry have resulted, and will continue to result, in reduced orders and delivery delays of new commercial aircraft, parking and retirement of older aircraft (eliminating those aircraft from maintenance needs) and delays in airlines purchases of aftermarket parts and service as maintenance is deferred. During periods of reduced airline profitability, some airlines may delay purchases of spare parts, preferring instead to deplete existing inventories. If demand for new aircraft and spare parts decreases, there would be a decrease in demand for certain of our products.

***The aerospace industry is subject to significant government regulation and oversight, and we may have to incur significant additional costs to comply with these regulations.***

The aerospace industry is highly regulated in the United States and in other countries. We must be certified or accepted by the FAA, the United States Department of Defense, the European Aviation Safety Agency, or EASA, and similar agencies in foreign countries and by individual OEMs in order to manufacture, sell and service parts used in aircraft. If any of our material certifications, authorizations or approvals are revoked or suspended, our operations will be significantly curtailed and we could be subjected to significant fines and penalties. In the future, new and more demanding government regulations may be adopted or industry oversight may be increased. We may have to incur significant additional costs to achieve compliance with new regulations or to reacquire a revoked or suspended license or approval, which could reduce our profitability.

***We compete with a number of established companies in all aspects of our business, many of which have significantly greater resources or capabilities than we do.***

The market for MRO services and parts services is highly competitive. Competition in the MRO market is based on price, quality, engineered solutions, ability to provide a broad range of services, turn-around time, and the ability to perform repairs and overhauls rapidly. Our primary MRO services competitors are the service divisions of OEMs, the in-house maintenance services of a number of commercial airlines and other independent service providers. For heat transfer component MRO services, our major competitors are the LORI Heat Transfer Center of Honeywell (Tulsa, Oklahoma) and SECAN-Honeywell (France). For APU, propeller and landing gear MRO services, our major competitors are Standard Aero Group Inc., Aerotech International Inc., Honeywell, Alameda Aerospace, Chromalloy, Messier-Dowty Aerospace (MD), AAR Corp., Hawker Pacific, APPH Ltd., Aero Precision Repair and Overhaul Company Inc, or APRO, Aircraft Propeller Service Inc, Pacific Propeller International LLC and H&H Propeller.

For our OEM heat transfer components, our major competitors are other OEMs who manufacture heat transfer components, including the Hughes-Treitler division of Ametek Inc., Lytron Inc., Hamilton Sundstrand and Honeywell. Some of our competitors are far larger, have substantially greater resources, including technical, financial, researchand development, marketing and distribution capabilities than we have, and enjoy greater market recognition. These competitors may be able to achieve greater economies of scale and may be less vulnerable to price competition than us. We may not be able to offer our products as part of integrated systems to the same extent as our competitors or successfully develop or introduce new products that are more cost effective or offer better performance than those of our competitors. Failure to do so could adversely affect our business, financial condition and results of operations.

The parts services industry is highly competitive and fragmented. Competition in this market is based on price, quality, prompt delivery and service. Competitors in this segment include original equipment manufacturers, the service divisions of large commercial airlines and other independent suppliers and distributors of parts.

A number of our competitors have inherent competitive advantages. For example, we compete with the service divisions of large OEMs who in some cases have design authority with respect to their OEM products and are able to derive significant brand recognition from their OEM manufacturing activities. We also compete with the in-house service divisions of large commercial airlines and there is a strong incentive for an airline to fully-utilize the services of its maintenance employees and facilities.

Further, our competitors may have additional competitive advantages, such as:

- the ability to adapt more quickly to changes in customer requirements and industry conditions or trends;
- greater access to capital;
- stronger relationships with customers and suppliers;
- greater name recognition; and
- access to superior technology and marketing resources.

If we are unable to overcome these competitive disadvantages, our business, financial condition and results of operations would be adversely affected.

***We derive a substantial part of our revenues from several major customers. If we lose any of these customers or they reduce the amount of business they do with us, our revenues may be seriously affected.***

Five customers accounted for approximately 22.0% and 31.4% of our revenues in the years ended December 31, 2006 and 2005 respectively, and four customers accounted for approximately 44.9% of our revenues in the year ended December 31, 2004. None of our customers accounted for more than 10% of our revenues in the year ended December 31, 2006. These customers may not maintain the same volume of business with us in the future. If we lose any of these customers or they reduce the amount of business they do with us, our revenues may be seriously affected.

***A substantial part of our revenues are from contracts with the U.S. and Israeli governments and is subject to special risks. A loss of all, or a major portion, of our revenues from government contracts could have a material adverse effect on our operations.***

A substantial portion of our revenues are from contracts with the U.S. and Israeli governments. Sales to the U.S. and Israeli governments, accounted for approximately 4.0% and 1.1% of our revenues for the year ended December 31, 2006, 11.1% and 1.2% of our revenues for the year ended December 31, 2005 and 10.6% and 2.6% of our revenues for the year ended December 31, 2004, respectively. Business with the U.S. and Israeli governments, as well as with the governments of other countries, is subject to risks which are not as relevant in business with private parties. These risks include the ability of the governmental authorities to unilaterally:

suspend us from receiving new contracts pending resolution of alleged violations of procurement laws or regulations;

terminate existing contracts, with or without cause, at any time;

reduce the value of existing contracts;

audit our contract-related costs and fees, including allocated indirect costs; and

control or potentially prohibit the export of our products.

A decision by a governmental authority to take any or all of the actions listed above could materially reduce our sales and profitability. Most of our U.S. Government contracts can be terminated by the U.S. Government either for its convenience or if we default by failing to perform under the contract. Termination for convenience provisions provide only for our recovery of costs incurred or committed, settlement expenses and profit on the work completed prior to termination.

Declines in military budgets may result in reduced demand for our products and manufacturing services. Any decline could result in reduction in our core business revenues and adversely affect our business, results of operations and financial condition.

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

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

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

***A reduced demand for replacement parts by one or more of our significant parts services customers could significantly reduce our parts services revenues.***

The profitability of our parts services business is driven by the needs of our customers whose demand for replacement parts is constantly fluctuating. As a result, this segment of our business is subject to a high degree of volatility, and a reduction in demand for parts by one or more of our significant clients would have an adverse affect on our operating results.

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

We acquire most of the components for the manufacture of our products from a limited number of suppliers, most of whom are located in Israel and the United States. Certain of these suppliers are currently the sole source of one or more components upon which we are dependent. Suppliers of some of these components require us to place orders with significant lead-time to assure supply in accordance with our requirements. We rely on Honeywell and Hamilton Sundstrand for parts for our OEM, MRO services and parts services business segments and in 2006 we entered into a five-year supply contract with Honeywell to purchase APU parts on an as-required basis. If we were unable to obtain adequate supplies of parts from Honeywell, Hamilton Sundstrand or other OEMs at commercially reasonable prices, our operations could be interrupted. Increased costs associated with supplied materials or components could increase our costs and reduce our profitability if we are unable to pass these cost increases on to our customers. We maintain a relatively small inventory of component parts for resale and our parts services business would suffer if the supply of replacement parts was reduced or terminated by our suppliers. There are other companies that may be able to supply us with necessary component parts. However, these potential suppliers would be required to undergo FAA, EASA and OEM certification, and this would make it difficult for us to change suppliers in a timely and cost-effective manner.

***We may face increased costs and a reduced supply of raw materials. We may not be able to recoup any future increases in the cost of raw materials or in electric power costs for our operations through price increases for our products.***

Since 2003, the cost of raw materials used in our production has fluctuated significantly due to market and industry conditions. The cost of electric power used in our operations has also increased in the last several years. We may not be able to recoup any future increases in the cost of raw materials or electric power costs through price increases for our products.

***We face special risks from international sales operations. One or more of the risks associated with international sales may have a material adverse effect on our future revenues and, as a result, our business, operating results and financial condition.***

Our international sales and operations, including exports, comprise a growing proportion of our operating results. In the years ended December 31, 2006 and 2005, approximately 90.9% and 91.6% of our sales, respectively, resulted from our international operations. This source of revenue is subject to various risks, including:

- governmental embargoes or foreign trade restrictions;
- changes in U.S. and foreign governmental regulations;
- changes in foreign exchange rates;
- tariffs;
- other trade barriers;
- political, economic and social instability; and difficulties in accounts receivable collections.

We may not be able to sustain or increase revenues from international operations or we may encounter significant difficulties in connection with the sale of our products in international markets or one or more of these factors may have a material adverse effect on our future revenues and, as a result, our business, operating results and financial condition.

***We may engage in future acquisitions that could dilute our stockholders equity and harm our business, results of operations and financial condition.***

We have pursued, and will continue to pursue, growth opportunities through internal development and acquisition of complementary businesses, products and technologies. We are unable to predict whether or when any other prospective acquisition will be completed. The process of integrating an acquired business may be prolonged due to unforeseen difficulties and may require a disproportionate amount of our resources and management s attention. We may not be able to successfully identify suitable acquisition candidates, complete acquisitions, integrate acquired businesses into our operations, or expand into new markets. Further, once integrated, acquisitions may not achieve comparable levels of revenues, profitability or productivity as our existing business or otherwise perform as expected. The occurrence of any of these events could harm our business, financial condition or results of operations. Future acquisitions may require substantial capital resources, which may require us to seek additional debt or equity financing.

Future acquisitions by us could result in the following, any of which could seriously harm our results of operations or the price of our ordinary shares:

- issuance of equity securities that would dilute our current shareholders percentages of ownership;
- large one-time write-offs;
- the incurrence of debt and contingent liabilities;
- difficulties in the assimilation and integration of operations, personnel, technologies, products and information systems of the acquired companies;
- diversion of management s attention from other business concerns;
- contractual disputes;
- risks of entering geographic and business markets in which we have no or only limited prior experience; and
- potential loss of key employees of acquired organizations.

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

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

***We have fixed-price contracts with some of our customers and we bear the risk of costs in excess of our estimates.***

We have entered into multi-year, fixed-price contracts with some of our MRO and OEM customers. Pursuant to these contracts, we realize all the benefits or costs resulting from any increases or decreases in the cost of providing services to these customers. Most of our contracts do not permit us to recover for increases in raw material prices, taxes or labor costs. Any increase in these costs could increase the cost of operating our business and reduce our profitability. Factors such as inaccurate pricing and increases in the cost of labor, materials or overhead may result in cost over-runs and losses on those agreements. We may not succeed in obtaining an agreement of a customer to reprice a particular product, and we may not be able to recoup previous losses resulting from incomplete or inaccurate engineering data.

***We depend on our key executives, and may not be able to hire and retain additional key employees or successfully integrate new members of our team and the loss of a key employee could have a material adverse effect on our business.***

Our success will depend largely on our continued reliance on the experience and expertise of our senior management. Although we have entered into employment agreements with most members of our senior management, any of our senior managers may terminate his employment with us and seek employment with others who may seek his expertise. The loss of the expertise of any of our senior management through death, disability or termination of employment would have a material and adverse effect on our business, financial condition and results of operations. We are not the beneficiary of life or disability insurance covering any of our executives, key employees or other personnel.

Our ability to implement our business strategy will depend on our success in recruiting, retaining and successfully integrating our management team and other personnel. If we are unable to retain employees and to attract and integrate new members of our management team, key employees or other personnel, we may be unable to successfully implement our business strategy in a timely manner. If we are unable to do so or if we were to lose the services of our senior executives or key employees, it could have a material adverse effect on our business, financial condition and results of operations.

***Our operations depend on maintaining a skilled workforce and any interruption in the work force at our facilities could curtail our operations.***

We derive the majority of our sales from overhaul services for components delivered to us from time to time by our customers. Because we maintain a relatively small inventory of loaner parts for our MRO services business, an interruption of our work force due to strikes, work stoppages, shortages of appropriately skilled production and professional workers or other interruption could have a material adverse impact on both our ability to keep our customers aircraft in service while we perform overhaul services and customer satisfaction.

***We depend on our manufacturing and MRO facilities, and any damage to these facilities would adversely impact our operations.***

We believe that our success to date has been, and future results of operations will be, dependent in large part upon our ability to provide MRO services and to manufacture and deliver OEM products promptly upon receipt of orders and to provide prompt and efficient service to our customers. As a result, any disruption of our day-today operations could have a material adverse effect on our business, customer relations and profitability. We rely on our Gedera, Israel, Tulsa, Oklahoma and Kernersville and Winston-Salem, North Carolina facilities for the provision of our MRO services, the production of our OEM products and the provision of our parts services. A fire, flood, earthquake or other disaster or condition that significantly damaged or destroyed any of these facilities would have a material adverse effect on our operations.

***We use equipment that is not easily repaired or replaced, and therefore equipment failures could cause us to be unable to meet quality or delivery expectations of our customers.***

Many of our service and manufacturing processes are dependent on equipment that is not easily repaired or replaced. As a result, unexpected failures of this equipment could result in production delays or the manufacturing of defective products. Our ability to meet the expectations of our customers with respect to on-time delivery of repaired components or quality OEM products is critical. Our failure to meet the quality or delivery expectations of our customers could lead to the loss of one or more of our significant customers.

***Compliance with corporate governance regulations could increase the cost of our operations.***

As a result of changing laws, regulations and standards relating to accounting, corporate governance and public disclosure, the costs of being a public company in general have increased in recent years. The Sarbanes-Oxley Act of 2002 requires changes in some of our corporate governance and securities disclosure or compliance practices. We expect that the on-going implementation of these regulations will further increase our legal compliance costs and will make some activities more time consuming. We are presently evaluating and monitoring regulatory developments and cannot estimate the magnitude of additional costs we may incur as a result of such developments. In connection with our future implementation of Section 404 of the Sarbanes-Oxley Act of 2002, which governs internal controls and procedures for financial reporting, we have expended and will need to further expend significant management time and financial resources to comply with the applicable requirements. This and other proposed legislation may increase the fees of our professional advisors and our insurance premiums.

***We have potential exposure to liabilities arising under environmental laws and regulations.***

Our business operations and facilities are subject to a number of federal, state, and local laws and regulations that govern the discharge of pollutants and hazardous substances into the air and water as well as the handling, storage and disposal of such materials and other environmental matters. Compliance with such laws as they relate to the handling, storage and disposal of hazardous substances is a significant obligation for us at each of our facilities. We would be subject to serious consequences, including fines and other sanctions, and limitations on our operations due to changes to, or revocations of, the environmental permits applicable to our facilities if we fail to comply. The adoption of new laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination or the imposition of new cleanup requirements could require us to incur costs and become subject to new or increased liabilities that could increase our operating costs and adversely affect the manner in which we conduct our business.

Under certain environmental laws, liability associated with investigation or remediation of hazardous substances can arise at a broad range of properties, including properties currently or formerly operated by us or our predecessors, as well as properties to which we sent hazardous substances or wastes for treatment, storage, or disposal. Costs and other obligations can arise from claims for toxic torts, natural resource and other damages, as well as the investigation and clean up of contamination at such properties. Under certain environmental laws, such liability may be imposed jointly and severally, so we may be responsible for more than our proportionate share and may even be responsible for the entire liability at issue. The extent of any such liability can be difficult to predict.

***We are exposed to potential liabilities arising from product liability and warranty claims.***

Our operations expose us to potential liabilities for personal injury or death as a result of the failure of an aircraft component that has been designed, manufactured, serviced or supplied by us. We believe that, in an effort to improve operating margins, some customers have delayed the replacement of parts beyond their recommended lifetime, which may undermine aircraft safety and increase our risk of liability.

We cannot assure you that we will not experience any material product liability losses in the future, that we will not incur significant costs to defend such claims, that our insurance coverage will be adequate if claims were to arise or that we would be able to maintain insurance coverage in the future at an acceptable cost. A successful claim brought against us in excess of our available insurance coverage may have a material adverse effect on our business.

In addition, in the ordinary course of our business contractual disputes over warranties can arise. We may be subject to requests for cost sharing or pricing adjustments from our customers as a part of our commercial relationships with them, even though they have agreed to bear these risks.

**Risk Factors Related to Our Ordinary Shares**

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

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

- quarterly variations in our operating results;
- operating results that vary from the expectations of securities analysts and investors;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- announcements of technological innovations or new products by us or our competitors;

- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments;
- changes in the status of our intellectual property rights;
- announcements by third parties of significant claims or proceedings against us;
- additions or departures of key personnel;
- future sales of our ordinary shares;
- de-listing of our shares from the NASDAQ Capital Market; and
- stock market price and volume fluctuations.

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

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

***Substantial future sales of our ordinary shares by our principal shareholders may depress our share price.***

Our principal shareholders, TAT Industries and Ta-Top, Limited Partnership, an Israeli limited partnership, or Ta-Top, hold 47.8% and 14.6% of our outstanding ordinary shares, respectively. If they sell substantial amounts of our ordinary shares, including shares issued upon the exercise of options, or if the perception exists that our principal shareholders may sell a substantial number of our ordinary shares, the market price of our ordinary shares may fall. Any substantial sales of our shares in the public market also might make it more difficult for us to sell equity or equity-related securities in the future at a time, in a place and on terms we deem appropriate.

**Risks Relating to Our Location in Israel**

***Because we have significant operations in Israel, we may be subject to political, economic and other conditions affecting Israel that could increase our operating expenses and disrupt our business.***

We are incorporated under the laws of, and our executive offices, manufacturing plant and research and development facilities are located in, the State of Israel. As a result, we are directly affected by the political, economic and military conditions affecting Israel. Specifically, we could be adversely affected by any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, or a significant downturn in the economic or financial condition of Israel.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, there has been an increase in unrest and terrorist activity in Israel, which began in September 2000 and which has continued with varying levels of severity through 2006. In July 2006, an armed conflict began between Israel and Hezbollah forces in Lebanon, which involved rocket attacks on populated areas in the northern parts of Israel. On August 14, 2006, a cease-fire between Hezbollah and Israel took effect. This situation has had an adverse effect on Israel s economy, primarily in the geographical areas directly harmed by this conflict. Any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. No predictions can be made as to whether or when a final resolution of the area s problems will be achieved or the nature thereof and to what extent the situation will impact Israel s economic development or our operations.

Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli companies, and we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

***We may be adversely affected by a change in the exchange rate of the NIS against the dollar. Because exchange rates between the NIS and the dollar fluctuate continuously, exchange rate fluctuations, particularly larger periodic devaluations, may have an impact on our profitability and period to period comparisons of our results.***

Because exchange rates between the NIS and the dollar fluctuate continuously, exchange rate fluctuations, particularly larger periodic devaluations, may have an impact on our profitability and period to period comparisons of our results. In the years ended December 31, 2001, 2002 and 2005 the rate of devaluation of the NIS against the dollar was 9.3%, 7.3% and 6.8 %, respectively, while in the years ended December 31, 2003, 2004 and 2006 the NIS appreciated in value in relation to the dollar by 7.6%, 1.6% and 8.2%, respectively. A portion of our expenses, primarily labor expenses, is incurred in NIS and a part of our revenues are quoted in NIS. Additionally, certain assets, as well as a portion of our liabilities, are denominated in NIS. Our results may be adversely affected by the devaluation of the NIS in relation to the dollar (or if such devaluation is on lagging basis), if our revenues in NIS are higher than our expenses in NIS and/or the amount of our assets in NIS are higher than our liabilities in NIS. Alternatively, our results may be adversely affected by an appreciation of the NIS in relation to the dollar (or if such appreciation is on a lagging basis), if the amount of our expenses in NIS are higher than the amount of our revenues in NIS and/or the amount of our liabilities in NIS are higher than our assets in NIS.

***Our results of operations may be negatively affected by the obligation of our personnel to perform military service.***

Generally, all non-exempt male adult citizens and permanent residents of Israel under the age of 45, including many of our executive officers and employees in Israel, are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

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

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our memorandum of association, articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and to refrain from abusing his power in the company, including, among other things, in voting at the general meeting of shareholders on certain matters. Israeli law provides that these duties are applicable in shareholder votes at the general meeting with respect to, among other things, amendments to a company s articles of association, increases in a company s authorized share capital, mergers and actions and transactions involving interests of officers, directors or other interested parties which require the shareholders general meeting s approval. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that he or she possesses the power to determine the outcome of a vote at a meeting of our shareholders, or who has, by virtue of the company s articles of association, the power to appoint or prevent the appointment of an office holder in the company, or any other power with respect to the company, has a duty of fairness toward the company. The Israeli Companies Law does not establish criteria for determining whether or not a shareholder has acted in good faith. Moreover, the law is relatively new and there is no case law available on the duty of a non-controlling shareholder to act in good faith.

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

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. In addition, our articles of association contain provisions that may make it more difficult to acquire our company, such as provisions establishing a classified board. Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to some of our shareholders. See Description of Share Capital Approval of Related Party Transactions and Israeli Taxation for additional discussion about some anti-takeover effects of Israeli law.

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

***Investors and our shareholders generally may have difficulties enforcing a U.S. judgment against us, our executive officers and directors or asserting U.S. securities laws claims in Israel.***

We are incorporated in Israel and all of our executive officers, most of our directors reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, all of our assets and most of the assets of our executive officers and directors are located outside the United States. Therefore, a judgment obtained against us or any of them in the United States, including one based on the civil liability provisions of the U.S. federal securities laws, may not be collectible in the United States and may not be enforced by an Israeli court. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in Israel. For more information regarding the enforceability of civil liabilities against us, our directors and executive officers and the Israeli expertsnamed in this prospectus, including the terms under which certain judgments may be enforced by an Israeli court, please see Enforceability of Civil Liabilities.

***As a foreign private issuer whose shares are listed on the NASDAQ Capital Market, we may follow certain home country corporate governance practices instead of certain NASDAQ requirements.***

As a foreign private issuer whose shares are listed on The NASDAQ Capital Market, we are permitted to follow certain home country corporate governance practices instead of certain requirements of the NASDAQ Marketplace Rules. A foreign private issuer that elects to follow a home country practice instead of such requirements, must submit to NASDAQ in advance a written statement from an independent counsel in such issuer s home country certifying that the issuer s practices are not prohibited by the home country s laws. In addition, a foreign private issuer must disclose in its annual reports filed with the Securities and Exchange Commission each such requirement that it does not follow and describe the home country practice followed by the issuer instead of any such requirement.

## Item 4. Information on the Company

### A. History and Development of the Company

We were incorporated under the laws of the State of Israel in April 1985 under the name Galaxy Graphics Ltd. In August 1986 we changed our name to Galagraph Ltd. In May 1992, we changed our name to TAT Technologies Ltd. We are a public limited liability company under the Israeli Companies Law 1999-5759, or the Israeli Companies Law, and operate under this law and associated legislation. Our registered offices and principal place of business are located at Re em Industrial Park, Neta Boulevard, Bnei Ayish, Gedera, Israel 70750 and our telephone number is +972-8-859-5411. Our address on the Internet is www.tat.co.il. The information on our website is not incorporated by reference into this annual report.

We are principally engaged in the manufacture and sale of a broad range of heat transfer components used in mechanical and electronic systems on-board commercial and military aircraft and in a variety of other electronic equipment. These systems, which include environmental control, avionics cooling and other mechanical and electronic mechanical systems, generate heat during operation that must be removed and dissipated in order to function properly. We are also engaged in the remanufacture, overhaul and repair of heat transfer components and other aircraft components manufactured by us and other companies. In addition, we manufacture, sell and service certain related products for use in aircraft and electronic systems. We conduct business in the United States through our wholly owned subsidiary Limco-Piedmont. Limco-Piedmont has recently filed a registration statement with U.S. Securities and Exchange Commission in connection with a proposed public offering of its securities.

We were founded in 1985 to develop the computerized systems business of our parent company, TAT Industries Ltd., a publicly held Israeli corporation engaged in the manufacture and sale of aeronautical equipment. In December 1991, we acquired the heat exchanger operations of TAT Industries and in February 2000, we entered into an agreement to purchase its operations relating to the manufacture of aviation accessories and to lease certain of its properties.

In March 1987, we completed the initial public offering of our securities in the United States. We were listed on NASDAQ National Market (now known as the NASDAQ Global Market) from our initial public offering until July 1998 when the listing of our ordinary shares was transferred to the NASDAQ Capital Market. Since August 2005 our shares are also traded on the TASE.

On July 7, 2005, we purchased Piedmont, an FAA certified company engaged in the repair and overhaul of various aircraft accessories. Under the terms of the acquisition, we paid $20.2 million including the assumption of Piedmont s outstanding indebtedness.

**B. Business Overview**
**Overview**

We manufacture a complete line of heat transfer components both in the United States and Israel, including heat exchangers, precoolers, oil coolers and cold plates, or heat transfer components. Heat transfer components facilitate the necessary removal and dissipation of heat generated during the operation of mechanical and electronic systems. Our heat transfer components are generally integrated into a complete cooling system. Using our technological expertise, we design each of our heat transfer products to meet the specific space, power, performance and other needs of our customers. Our heat transfer components are marketed worldwide for applications in commercial and military aircraft and electronic systems, the primary users of such equipment. Our customers include Liebherr-Aerospace Toulouse S.A., or Liebherr, Boeing McDonnell Douglas Aerospace, or Boeing, Israel Aircraft Industries, or IAI, and Cessna Aircraft Company, or Cessna, as well as the United States Air Force and Navy. Such customers typically enter into supply contracts with us pursuant to which we manufacture specified Heat transfer components in connection with the customers production or retrofitting of particular aircraft equipment. Such supply contracts are generally for a period of between one to four years.

In addition, we design, develop and manufacture aviation accessories. These accessories include fuel components, such as valves and pumps, secondary power systems, various instrumentation and electronic assemblies. Customers for our aviation accessories include Lockheed-Martin Corp, or Lockheed-Martin, Teledyne Continental Motors, or Teledyne, the Israeli Air Force, IAI, as well as the United States Air Force and Navy. We currently overhaul emergency power systems, hydrazine tanks, jet fuel starters, and cooling turbines and valves for F-16s. In addition we overhaul anti-icing valves and starters for the Apache helicopter. Customers for our systems overhaul services include the Israeli Air Force, IAI, NATO air forces, as well as the United States Air Force and Navy.

We also specialize in the repair and overhaul of heat transfer components, APUs, propellers, landing gear and pneumatic ducting. Heat transfer components are devices that efficiently transfer heat from one fluid to another or from hot air to colder air in various cooling systems and are essential components of an aircraft. These components include heat exchangers, oil coolers, precoolers, reheaters, condensers, water separators and evaporators. APUs are relatively small, self-contained generators used to start jet engines , usually with compressed air, and to provide electricity, hydraulic pressure and air conditioning while an aircraft is on the ground. In many aircraft, an APU can also provide electrical power in the air

Our parts services division provides a number of services for commercial, regional and charter airlines and business aircraft owners, including inventory management and parts services. We assist these customers with their parts procurement needs by using our knowledge of the aircraft component industry to quickly acquire necessary aircraft components in a cost-effective manner. We have a knowledgeable and experienced staff of 10 customer service representatives and offer our customers 24 hour service and same day shipping.

**Business Strategy**

Our principal growth strategy both in the United States and Israel is to: (i) expand our heat transfer components business in existing and new markets; (ii) provide overhaul and repair services for additional aircraft components; (iii) expand our marketing of overhaul and repair services to additional segments of the aerospace industry; and (iv) use our technological expertise to expand into related businesses.

Our growth strategy is to:

*Expand the scope of our MRO services.* We intend to use our technical expertise, engineering resources and comprehensive facilities to provide MRO services for additional types of aircraft and additional air- craft systems, subsystems and components and intend to devote additional financial resources to develop the required technical expertise to provide such additional MRO services. As we expand our MRO service capabilities, we believe that we will be able to offer a more complete MRO service solution to our current and future customers. In the year ended December 31, 2006, we increased our heat exchanger capabilities and are presently adding the capability to service the Honeywell model 331 APU which is used in the Boeing 757 and 767 aircraft and other aircraft. We also intend to increase our MRO capabilities to include additional types of heat transfer components and landing gear and other accessories.

*Expand the scope of our OEM business.* We intend to capitalize on our technical expertise, experience and reputation in the heat transfer components market to expand the scope of our OEM offerings and to enter into new markets. For example, we have identified the electronics industry as a market with significant growth potential for our heat transfer components. For the past several years we have been engaged in the design, development and manufacture of electronic heat dissipation equipment such as cold plates, heat sinks, cold walls and other components which remove and dissipate heat from electronic systems.

*Increase our international sales.* As part of our efforts to achieve greater penetration in the international markets, we intend to expand our marketing presence in Western Europe, which is our second largest market, and to substantially increase our presence in China , Far East and other Asian nations, which are fast growing markets where we have had limited sales to date. Our management team has in the past considered an opportunity to open a repair station in China as part of a joint venture with a local partner and has investigated the possibility of establishing a facility in Asia. The establishment of such a repair station would enable us to provide MRO services in the region and would facilitate our penetration into this market.

*Selectively pursue acquisition opportunities.* We believe that additional acquisition opportunities exist that will complement our OEM and MRO businesses. We will continue to pursue targeted complementary business acquisitions which will broaden the scope and depth of our OEM and MRO operations and increase our market share, although we have no present specific plans, proposals or arrangements with respect to any such acquisition.

*Increase our cross-selling efforts.* Until we acquired Piedmont in July 2005, our MRO services were limited to heat transfer components and pneumatic ducting. With our acquisition of Piedmont, we expanded our MRO services capabilities to include APUs, propellers and landing gear and added a parts services business. The expansion of our MRO service offerings allows us to offer a more complete MRO service solution to our current customer base. Consequently, we intend to increase our cross-selling efforts and offer the full range of our services to the historical customers of Limco and the new customers we obtained with the acquisition of Piedmont. We also intend to increase our marketing efforts to our current customer base by employing additional marketing and sales personnel in 2007, increasing our attendance at trade shows and by placing additional advertisements in relevant trade publications.

**Our Business**

**OEM products**

We manufacture a wide range of heat transfer components used in commercial, regional, business and military aircraft, air conditioning systems, complete environmental control systems and cooling systems for electronics. These parts are manufactured in compliance with all of the stringent quality assurance standards that apply to the manufacture of aircraft parts. Our quality systems comply with ISO 9001, AS9100, Boeing quality systems approval D6-82479, and FAR 21.303 (the FAA standard for Parts Manufacturer Approval).

We manufacture a wide range of heat transfer components both in the United States and Israel. We specialize in the design and manufacturing of highly efficient, compact and reliable heat transfer components that are designed to meet stringent constraints such as size, weight and applicable environmental conditions. Heat transfer components, such as heat exchangers, precoolers, evaporators, oil coolers and cold plates, are integral components of a wide variety of environmental control systems and mechanical and engine systems, as well as a wide range of electronic systems. These systems generate heat during operation that must be removed and dissipated. Heat transfer components facilitate the exchange of the heat created through the operation of these systems by transmitting the heat from a hot medium (air, oil or other fluids) to a cold medium for disposal.

In the aerospace industry, there is a constant need for improvements in performance, weight, cost and reliability. In addition, as electronic systems become smaller and more densely packed, the need for sophisticated and efficient heat transfer components to provide the cooling functions becomes more critical. Using our technological expertise, we believe we are well positioned to respond to these industry demands through continued new product development and product improvements.

Our principal heat transfer components products include air-to-air heat exchangers and precoolers and liquid-to-air heat exchangers. Typically, the air-to-air heat exchangers and precoolers cool a jet engine s hot bleed air which, when cooled, is then used in the aircraft s air conditioning, pressurization and pneumatic systems. The liquid-to-air heat exchangers cool liquids such as engine oil, hydraulic oil and other liquid coolants used in other systems.

We believe that the global commercial OEM aerospace market in 2005 was approximately $400 million for heat exchangers, $300 million for cold plates, $300 million for air conditioning and $10 billion for flow accessories.

We provide anywhere from one to all of the different types of heat transfer components in certain aircraft. Wide body planes require generally seven different types of heat transfer components, while regional aircraft and helicopters contain approximately three types. Our heat exchangers and precoolers, which are types of heat transfer components found in most aircraft, are generally sold for between $1,000 and $20,000 per unit. A substantial portion of our heat transfer components are sold to customers in connection with the original manufacture or retrofitting of particular aircraft equipment. We generally enter into long-term supply contracts with our customers, which require us to supply Heat transfer components as part of a larger project.

We also manufacture heat dissipation equipment, such as evaporators, cold plates, cooling chests, heat sinks and cold walls (which may be air-to-air, liquid-to-air or liquid-to-liquid), which control and dispose of heat emitted by the operation of various electronic systems. These heat dissipation products are currently utilized mainly in radar systems, avionics, electronic warfare systems and various pods for targeting, navigation and night vision.

Our customers for heat transfer components include: Liebherr, Boeing, IAI, Cessna, Bell Helicopter, or Bell, and Raytheon Aircraft Company, or Raytheon, as well as the United States Air Force and Navy. As a result of the specialized nature of the systems in which our parts are included, spare and replacement parts for the original heat transfer systems are usually provided by us.

We are also engaged in the design, development and manufacture of aviation accessories. These accessories include fuel component systems, such as valves and pumps, secondary power systems, various instrumentation and electronic assemblies. Our customers for the design, development and manufacture of aviation accessories include Lockheed-Martin, Boeing, Teledyne, the Israeli Air Force, IAI, as well as the U.S. Air Force and Navy.

**MRO Services**

We provide services for the components segment of the MRO services market. Our MRO services segment includes the repair and overhaul of heat transfer components, APUs, propellers, landing gear and pneumatic ducting, among other components. Generally, manufacturer specifications, government regulations and military maintenance regimens require that aircraft components undergo MRO servicing at regular intervals or as necessary. Aircraft components typically require MRO services, including repairs and installation of replacement units, after three to five years of service or sooner if required. Aircraft manufacturers typically provide warranties on new aircraft and their components and subsystems, which may range from one to five years depending on the bargaining power of the purchaser. Warranty claims are generally the responsibility of the OEM during the warranty period. Our business opportunity usually begins upon the conclusion of the warranty period for these components and subsystems.

The global market for commercial MRO services was approximately $38.8 billion in 2005 according to AeroStrategy, and the components sector in which we participate accounted for approximately 21% of the commercial MRO market. The global market for military aircraft MRO was estimated to be approximately $56 billion in 2005 according to AeroStrategy, of which approximately $9.2 billion was for components.

We are licensed by Hamilton Sundstrand, a leading provider of aerospace products, to provide MRO services for all of their air-to-air heat transfer products and by Honeywell Aerospace, or Honeywell, a leading manufacturer of aerospace products and an aerospace services provider, to provide MRO services for three of their APU models. Our repair stations are certified by the FAA and the European Aviation Safety Agency, or EASA. In conjunction with our MRO services, we also manufacture heat transfer components used in commercial, regional, business and military aircraft, complete environmental control systems and cooling systems for electronics.

We specialize in the repair and overhaul of heat transfer components, APUs, propellers, landing gear and pneumatic ducting. Heat transfer components are devices that efficiently transfer heat from one fluid to another or from hot air to colder air in various cooling systems and are essential components of an aircraft. These components include heat exchangers, oil coolers, precoolers, reheaters, condensers, water separators and evaporators. APUs are relatively small, self-contained generators used to start jet engines, usually with compressed air, and to provide electricity, hydraulic pressure and air conditioning while an aircraft is on the ground. In many aircraft, an APU can also provide electrical power in the air.

We are continually increasing our MRO capabilities based upon market need or customer request. Our capabilities include, although are not limited to, components used in aircraft manufactured by the following aircraft manufacturers:

- Airbus
- ATR
- Boeing
- Bombardier
- British Aerospace
- Cessna
- Embraer
- Fairchild
- Fokker
- General Dynamics
- Gulfstream
- Lockheed Martin
- Raytheon
- SAAB
- Shorts

We perform our MRO services at our four repair stations in Oklahoma and North Carolina, all of which are licensed by the FAA and EASA to provide MRO services. Our Oklahoma facility, which is undergoing AS 9100 certification, provides MRO services for heat transfer components and pneumatic air-handling ducting. Our North Carolina facilities, which are ISO 9001 certified, provide MRO services for APUs, propellers and landing gear.

We believe that we are one of the two leading providers of MRO services for heat transfer components. Established in 1974, our Oklahoma facility provides testing, minor repair, overhaul, and remanufacturing for the following types of heat transfer components that are used in commercial and military aircraft:

- heat exchangers
- oil coolers
- Precoolers
- Reheaters
- condensers
- evaporators
- water separators

We offer MRO services for heat transfer components to our customers on multiple levels. If the damage is significant, we will remanufacture the unit, which generally entails replacing the core matrix of the damaged or old heat transfer product in lieu of replacing the entire unit with a new one. We design and develop these customized remanufactured units as a cost effective alternative to new part replacement. In the event of less severe damage, we will either overhaul or repair the unit as necessary. Re-manufactured units carry warranties identical to those provided to new units.

Our Oklahoma repair station also specializes in providing fast and efficient quality repair and overhaul of pneumatic air-handling ducting that is used in airframes, air conditioning systems, anti-icing systems, APUs, engines and exhaust systems.

Our Kernersville, North Carolina facility specializes in providing MRO services for three APU models manufactured by Honeywell (models 30, 36, and 85), and we expect to be able to provide MRO services for the

Honeywell model 331 later this year. APUs are self-contained units that are used in aircraft to start the main engines, usually with compressed air, and to provide electrical power, hydraulic pressure and air conditioning while the aircraft is waiting on the ground and during in-flight emergency situations.

Our Winston-Salem, North Carolina facility specializes in providing MRO services for propellers manufactured by Hartzell Propeller Inc. and McCauley Propeller Systems, including their fixed pitch aluminum and composite material blades, and propellers manufactured by Hamilton Sundstrand and Dowty Rotol. In addition, our North Carolina facilities provide MRO services for landing gear for regional aircraft manufactured by Bombardier Canadair Regional Jet, ATR, British Aerospace Jet Stream and Bombardier Dash 8.

We believe that establishing and maintaining relationships with OEMs is an important factor in achieving sustainable success as an independent MRO service provider. OEMs grant participants in the overhaul and repair services market authorizations or licenses to perform repair and overhaul services on the equipment they manufacture. OEMs generally maintain tight controls in order to maintain high quality of service to their customers, and in certain cases, grant very few authorizations or licenses. Obtaining OEM authorizations requires sophisticated technological capabilities, experience-based industry knowledge and substantial capital investment. We believe that service providers that have received OEM authorizations and licenses gain a competitive advantage because they typically receive discounts on parts, technical information, OEM warranty support and use of the OEM name in marketing. We are an independent MRO service provider that is licensed by Hamilton Sundstrand, the largest heat transfer components manufacturer, for its air-to-air heat transfer components in North America and are one of only two North American companies licensed by Honeywell, the largest manufacturer of APUs, for three of its APU models. We are also a licensed MRO service provider for propellers manufactured by Hartzell Propeller Inc. and McCauley Propeller Systems.

Each of the authorizations or licenses that we have with OEMs is in the form of a contractual arrangement. Some of these contracts require us to pay an authorization fee to the OEM and, in some cases, we are also required to pay annual authorization fees and royalties, or to fulfill other conditions set by the OEM. None of our material authorizations or licenses expires prior to 2008. Our OEM licenses from Hamilton Sundstrand will expire in May 2008 but may be extended through May 2013, and our OEM license from Honeywell will expire in June 2011.

***Engineering Capabilities***

Our engineering department supports our OEM activity and also enhances our ability to provide our customers with high-end top quality MRO services. Our engineering departments employ seven certified mechanical and aerospace engineers, including a Designated Engineering Representative, or DER, certified by the FAA. Our multi-disciplinary team of engineers specializes in heat transfer components and supports all processes of thermal and structural analysis, mechanical and metallurgical research and development for manufacturing design. Our engineers have direct experience with aerospace component repair and have experience with the process of obtaining supplemental type certificates from the FAA and in obtaining FAA product manufacturing authorizations. Our onsite DER is certified by the FAA to approve the repair of engines, APUs, and mechanical systems and equipment, which enables us to respond quickly to our customers needs. Having a DER on staff allows us to enter the market for a particular type of service more quickly that those of our competitors who do not employ a DER. We work directly with the FAA Aircraft Certification Office in obtaining approvals on projects that are outside our DER s authority.

An example of the value provided by our engineering staff is the development of a remanufacturing process which is based on replacing the failed core material (known as the core matrix) of heat transfer components with a new core. This process enables us to provide overhauled units to our customers for significantly less than the cost of a new unit.

We believe that our engineering staff provides us with the ability to support our OEM customers with innovative and efficient products while maintaining short product development cycles, high quality design and competitive pricing.

**Parts Services**

Our parts services division provides a number of services for commercial, regional and charter airlines and business aircraft owners, including inventory management and parts services. We presently assist several of these customers with their parts procurement needs by using our knowledge of the aircraft component industry to quickly acquire necessary aircraft components in a cost-effective manner. We have a knowledgeable and experienced staff of 10 customer service representatives and offer our customers 24 hour service and same day shipping. We currently supply parts to approximately 500 commercial, regional and charter airlines and business aircraft owners.

Our parts services division provides a number of services for commercial, regional and charter airlines and business aircraft owners, including inventory management and parts services. We assist these customers with their parts procurement needs by using our knowledge of the aircraft component industry to quickly acquire necessary aircraft components in a cost-effective manner. We have a knowledgeable and experienced staff of 10 customer service representatives and offer our customers 24 hour service and same day shipping.

We currently supply parts to approximately 500 commercial, regional and charter airlines and business aircraft owners. For these customers, we purchase parts against orders and resell at a margin. We also maintain a small inventory of commonly-replaced parts to improve our response time on orders. As our customers aircraft fleets go through their repair cycles, their parts requirements change from one year to the other.

Our parts services division specializes in Honeywell s 85 and 36 series APU models, Honeywell line replacement units, Hartzell propellers, McCauley propellers, APPH landing gear, and Embraer, Raytheon, Purolator-Facet, Messier Dowty, Boeing, PM Research and BP Oil parts.

We believe that the growth of our parts services division is attributable to our access to the large inventory of component parts we maintain for our MRO services, our favorable pricing for parts purchased pursuant to licenses with OEMs and from our reputation for good and prompt service. We also benefit from the purchasing power we have gained as a result of the large number of parts we purchase for our MRO services. We are continuing our efforts to increase our recognition in the market by attendance at tradeshows, industry advertising and promoting our website.

**Customers**

**Major Customers**

Our products and services are provided worldwide to OEMs and end-user customers in the commercial, military and industrial markets. For the fiscal years ended December 31, 2006 and 2005 our major customers were:

| | **Years Ended** | | | |
|---|---|---|---|---|
| | **December 31, 2006** | | **December 31, 2005** | |
| **Customer** | **Revenues in Thousands** | **Percentage** | **Revenues in Thousands** | **Percentage** |
| Elta | $ 2,752 | 3.5% | $ 1,451 | 2.9% |
| Fokker | 5,460 | 7.0% | 2,536 | 5.1% |
| Liebherr | 3,504 | 4.5% | 2,940 | 5.8% |
| Lockheed-Martin | 2,360 | 3.0% | 3,209 | 6.5% |
| U.S. Government | 3,093 | 4.0% | 5,468 | 11.1% |
| Total | $ 17,169 | 22.0% | $ 15,604 | 31.4% |

*OEM Customers.* We currently sell our OEM products to commercial and military aircraft manufacturers and defense contractors and the U.S. government. Our customers, include Elta, Liebherr, Lockheed-Martin, Teledyne, Thales, Hamilton, Cessna, IAI , Boeing and Bell.

*MRO Customers.* We currently service approximately 150 MRO customers, including major domestic and international airlines, air cargo carriers, maintenance service centers and the military. Our ten largest MRO customers accounted for approximately 42% and 38% of our consolidated 2005 and 2006 sales, respectively. No customer accounted for more than 10% of our total sales in these periods. Our customers, includeRaytheon and end-users such as KLM, Lufthansa, Bell, Raytheon and the U.S. Air Force and Navy.

*Parts Services Customers.* We are not a party to any parts services contracts, and purchase parts against orders received from our customers. Our five largest parts services customers accounted for approximately 69.1% of our parts services sales in 2006.

**Military Contracts**

Sales to the U.S. and Israeli governments accounted for approximately 4.0% and 1.1% of our revenues in the year ended December 31, 2006, approximately 11.1% and 1.7 % of our revenues in 2005, and approximately 10.6 % and 2.6 % of our revenues in 2004, respectively.

Many of our contracts are competitively bid and awarded on the basis of technical merit, personnel qualifications, experience and price. We also receive some contract awards involving special technical capabilities on a negotiated, noncompetitive basis due to our technical capabilities.

We provide products under government contracts that usually require performance over a period of several months to five years. Long-term contracts may be conditioned upon continued availability of congressional appropriations. Variances between anticipated budget and congressional appropriations may result in a delay, reduction or termination of these contracts.

The vast majority of our government contracts are fixed-price contracts. Under these contracts we agree to perform specific work for a fixed price and, accordingly, realize the benefit or detriment to the extent that the actual cost of performing the work differs from the contract price. Our allowable government contract costs and fees are subject to audit and may result in non-reimbursement of some contract costs and fees. Audits conducted for periods through fiscal year 2006 have resulted in no material cost recovery disallowances for us.

Some of our government contracts contain options that are exercisable at the discretion of the customer. An option may extend the period of performance for one or more years for additional consideration on terms and conditions similar to those contained in the original contract. An option may also increase the level of effort and assign new tasks to us. In our experience, these options are typically exercised.

Our eligibility to perform under our certain government contracts requires us to maintain adequate security measures. We have implemented security procedures that we believe adequately satisfy the requirements of our federal government contracts.

**Sales and Marketing**

We derive our revenues mainly from sales to customers in the United States, Israel and Europe. The geographic distribution of such sales is as follows:

| | Years Ended | | | |
|---|---|---|---|---|
| | December 31, 2006 | | December 31, 2005 | |
| Geographic Region | Revenues in Thousands | Percentage | Revenues in Thousands | Percentage |
| United States | $ 51,292 | 66.2% | $ 30,495 | 62.0% |
| Europe | 15,210 | 19.6% | 11,256 | 22.9% |
| Israel | 7,042 | 9.1% | 4,122 | 8.4% |
| Asia | 1,953 | 2.5% | 1,983 | 4.0% |
| Other | 2,036 | 2.6% | 1,337 | 2.7% |
| Total | $ 77,533 | 100.00% | $ 49,193 | 100.00% |

We market our products and services through our marketing staff and a worldwide network of independent representatives. Our representatives are strategically located near key customer sites in offices throughout the United States, Europe, Asia, the Middle East and South America. Our staff is in regular contact with engineering and procurement personnel and program managers of existing and target customers to identify new programs and needs for our products, obtain requests for quotations and identify new product opportunities. Our marketing activities also include advertising in technical publications which target heat transfer components and related markets, attending exhibitions, trade shows and professional conferences, organizing seminars and direct mailing of advertisements and technical brochures to current and potential customers.

Our parts services division employs 10 persons in its customer service staff. These individuals are responsible for handling orders and contacting target customers and are available to our clients 24 hours a day, seven days a week.

**Backlog**

On June 22, 2007, we had a backlog of approximately $19 million for products as compared to a backlog of approximately $17 million for products to be delivered at June 20, 2006. We anticipate that approximately $13 million of our backlog at June 22, 2007 will be delivered by December 31, 2007 and approximately $6 million will be delivered by December 31, 2008.

**Product and Service Warranties**

We provide warranties for our products and services ranging from one to five years, which vary with respect to each contract and in accordance with the nature of each specific product. To date, our warranty costs have not been substantial. As of December 31, 2006 the aggregate amount of the warranty provision is not material.

**Competitive Environment**

A number of our competitors have inherent competitive advantages. For example, we compete with the service divisions of large OEMs who in some cases have design authority with respect to their OEM products and are able to derive significant brand recognition from their OEM manufacturing activities. We also compete with the in-house service divisions of large commercial airlines and there is a strong incentive for an airline to fully-utilize the services of its maintenance employees and facilities. Further, our competitors may have additional competitive advantages, such as:

- the ability to adapt more quickly to changes in customer requirements and industry conditions or trends;
- greater access to capital;
- stronger relationships with customers and suppliers;
- better name recognition; and
- access to superior technology and marketing resources.

*OEM Products*

The heat transfer field requires specialized technology, equipment and facilities, an experienced technical and engineering staff, as well as highly sophisticated and trained technicians. Although these factors have tended to limit the number of manufacturers who enter this field, it nonetheless remains very competitive. The major manufacturers in the field are Honeywell and Hamilton. Other manufacturers in the United States are Hughes-Treitler division of Ametek Inc., Lytron Inc., Hamilton Sundstrand and Honeywell, Stewart Warner South Wind Corp., United Aircraft Products, Triumph, and manufacturers based in Europe include I.M.I. Marston Ltd., Normalair Garrett Ltd., or NGL, Honeywell-SECAN France, or SECAN, and Behr Industry GMBH & Co KG.

*MRO Services*

The market for MRO services is highly competitive. Competition in this market is based on quality, price, and the ability to provide a broad range of services and to perform repairs and overhauls rapidly. Our primary MRO services competitors are the service divisions of OEMs, the in-house maintenance services of a number of commercial airlines and other independent service providers. For heat transfer component MRO services our major competitors are the LORI Heat Transfer Center of Honeywell and SECAN-Honeywell (France). For APU, propeller and landing gear MRO services our major competitors are Standard Aero Group Inc., Aerotech International Inc., Honeywell, Alameda Aerospace, JetSet Aerospace LLC, Messier-Dowty Aerospace (MD), AAR Corp., Hawker Pacific, APRO, Aircraft Propeller Service Inc., Pacific Propeller International LLC and H&H Propeller.

*Parts Services*

The parts services industry is highly competitive and fragmented. Competition in this markets is based on price, quality and service. Competitors in this segment include OEMs, the service divisions of large commercial airlines and other independent suppliers and distributors of parts.

**Engineering and Manufacturing**

We and our subsidiaries employ 366 persons engaged in engineering and manufacturing, repair, and testing of products. Our engineering staff has extensive knowledge and experience related to our heat transfer components. Most of our product lines have a designated project manager who is an experienced engineer and is in charge of all the activities in his area. The product manager interfaces with the customer, engineering department, manufacturing department and vendors, and is responsible for all aspects of the program including scheduling, adherence to specifications, customer support and reporting.

In general, we have manufacturing capabilities for most of the components of our heat transfer components. We also manufacture the necessary tools, fixtures, test equipment and special jigs required to manufacture, assemble and test these products. We have developed proprietary design techniques and computer-aided design software which assists in the mechanical design and manufacturing of our products. All of our products are inspected and tested by trained inspectors using highly sophisticated test equipment in accordance with customer requirements.

We are dependent upon single sources of supply for certain components and seek to maintain an adequate inventory of all imported components. Our Israeli operations employ the services of a purchasing agent, which is a corporation wholly-owned by certain of our officers and directors. See Item 13. Interest of Management in Certain Transactions.

**Source and Availability of Raw Materials and Spare Parts**

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

We depend on a number of OEMs for parts for our OEM and MRO operations and our parts services business. Our authorizations from OEMs often require that we purchase component parts that are needed for our MRO services from them or their designated distributors. We made 19.6% and 18.8% of our parts purchases from Honeywell and 9.8% and 8.4% of our parts purchases from Hamilton Sundstrand in 2006 and 2005, respectively. We have an agreement with Honeywell under which Honeywell has agreed to sell us certain of their parts at a discount for a period of five years, ending May 31, 2011.

In the year ended December 31, 2006, we purchased $6.7 million of parts from Honeywell, $3.2 million of parts from Hamilton Sundstrand. The loss of any of these key suppliers or an unfavorable modification of any of our agreements with such suppliers could have a material adverse effect on our business. We have at times experienced delays in receiving parts from our key suppliers, and any significant future delays could have a material adverse effect on our business and results of operations. If we had to develop alternative sources of supply, our ability to supply parts to our customers when needed could be impaired, business could be lost and margins could be reduced in both our MRO services and parts services segments.

We select our suppliers primarily based on their ability to ensure that their parts are serviceable and traceable to OEM-approved sources, their delivery performance and their ability to help us reduce our total cost of procuring those parts. For quality control, cost and efficiency reasons, we generally purchase supplies only from vendors with whom we have ongoing relationships or who our customers have previously approved. We have qualified second sources or have identified alternate sources for many of our parts services needs.

**Government Regulations**

Our operations in Israel are subject to supervision by the Ministry of Defense and Civil Aviation Administration. We are certified by the Israeli Air Force for the Ministry of Defense for both manufacturing and maintenance. We are also licensed as a repair station for certain components by the Israeli Civil Aviation Administration. In addition, our export of certain products and/or know-how is subject to approval by The Foreign Defense Assistance and Defense Export Organization of the Israeli Ministry of Defense, or SIBAT. Permits from SIBAT must be obtained for the initiation of sales proposals with regard to such exports, as well as for the actual export of such products.

*Aerospace and Safety Regulations*

The commercial aerospace industry is highly regulated by the FAA in the United States, EASA in Europe, the Civil Aviation Authority in England and other governmental authorities elsewhere in the world, while the military aerospace industry is governed by military quality specifications established by the U.S. Department of Defense for the manufacturing and repair industries and ISO-9001. We are required to be certified by one or more of these entities and, in some cases, by individual OEMs. We must also satisfy the requirements of our customers, including OEMs and airlines, that are subject to FAA regulations, and provide these customers with products that comply with the government regulations applicable to commercial flight operations. We currently satisfy or exceed these FAA maintenance standards in our repair and overhaul activities. We maintain four repair stations approved by the FAA, two in Oklahoma and two in North Carolina.

Our operations are also subject to a variety of worker and community safety laws including The Occupational Safety and Health Act of 1970, known as OSHA, which mandates general requirements for safe workplaces for all employees. In addition, OSHA provides special procedures and measures for the handling of certain hazardous and toxic substances. We believe that our operations are in material compliance with OSHA s health and safety requirements.

We believe that we are in material compliance with the governmental regulations affecting the aerospace and defense industry.

*Environmental Matters*

Our operations are subject to a number of laws in Israel and the United States, and to regulation by government agencies, including the U.S. Environmental Protection Agency. Among other matters, these regulatory authorities impose requirements that regulate the emission, discharge, generation, management, transportation and disposal of pollutants and hazardous substances. These authorities may require us to initiate actions to remediate the effects of hazardous substances which may be or have been released into the environment, and require us to obtain and maintain permits in connection with our operations. This extensive regulatory framework imposes significant compliance burdens and risks.

Although we seek to maintain our operations and facilities in compliance with applicable environmental laws, there can be no assurance that we have no violations, or that changes in such laws, regulations or interpretations of such laws or in the nature of our operations will not require us to make significant additional expenditures to ensure compliance in the future. Currently, we do not believe that we will have to make material capital expenditures for our operations to comply with environmental laws or regulations, or to incur material costs for environmental remediation during the 2007 fiscal year.

We have received no third party environmental claims relating to the our facilities, and we believe that we have all material licenses and certifications that are required in the jurisdictions in which we operate.

**Export Policy**

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

**Proprietary Rights**

At the present time we do not own any patents. We rely on laws protecting trade secrets, and consider such items proprietary, but believe that our success depends less on the ownership of such proprietary rights than on our innovative skills, technical competence marketing and engineering abilities. We have no existing material registered trademarks.

**C. Organizational Structure**

We are 47.8% owned by TAT Industries, a holding company incorporated under the law of the State of Israel whose shares are traded on the TASE.

Our wholly-owned subsidiary Limco-Piedmont is incorporated under the laws of Delaware and located in Tulsa, Oklahoma. Its Limco-Airepair subsidiary is certified by the FAA to engage in the remanufacture, overhaul and repair of heat transfer components for the aviation industry. Limco-Piedmont s Piedmont subsidiary was organized under the laws of North Carolina and its facilities are located in Kernersville and Winston Salem, North Carolina. Piedmont is certified by the FAA to engage in the repair and overhaul of various aircraft accessories.

**D. Property, Plants and Equipment**

Our executive offices, research and development and manufacturing facilities in Israel are located in a 31,679 square foot facility located in Park Re em near Gedera. The land of this facility is leased from the Israeli Government pursuant to a lease that expires in 2020, which was assigned, but not registered, to us by TAT Industries in connection with our acquisition of TAT Industries heat exchanger operations in December 1991. See Item 7. Major Shareholders and Related Party Transactions.

In connection with the purchase of the operations relating to the manufacture of aviation accessories of TAT Industries in February 2000, we and TAT Industries entered into a lease agreement, pursuant to which we are leasing from TAT Industries approximately 329,000 square feet, including 90,000 square feet of office space, for a period of 24 years and 11 months. From 2000 to 2004 we paid TAT Industries annual rental fees of approximately $300,000 per year, with an additional incremental payment of 2% per year. The rental fee is subject to revaluation every fifth year. In 2005 the rental fee was reviewed by a real estate appraiser, and as a result was increased to $310,000 per year with an additional incremental payment of 2% per year. The rental fee will be subject to an increase in 2010. We are entitled to a one-time right of termination of the agreement after 10 years.

Limco-Piedmont owns and operates a 55,000 square foot manufacturing plant in Tulsa, Oklahoma which supports both our OEM business and our aftermarket heat transfer component repair station. This facility also houses Limco-Piedmont s administration, engineering, quality control and support services. We also lease an additional 9,000 square foot repair station adjacent to the Tulsa manufacturing plant to support the growth of our heat transfer component and pneumatic ducting MRO services. This five-year lease agreement, which expires on September 1, 2011, provides for one renewal option for a five year term. For the initial five year term, the annual rent is $43,200 per year and increases to $45,600 per year for the two year period ending September 1, 2011. If the renewal option is exercised, the annual rent for that five year term would be $45,600 per year plus the increase in the consumer price index as compared to September 1, 2006.

We lease approximately 56,000 square feet space for our facility in Kernersville, North Carolina. In 2007, the annual rental expenses for this property will be $69,060. The lease, which expires on November 1, 2011, provides for two renewal options, each for a five year term. In addition, we also lease approximately 31,000 square feet space for our facility in Winston Salem, North Carolina. The lease, which provides for an annual rental expense of $6,000 in 2006, expires on November 1, 2007, and we expect a significant increase in the rental expense for this facility, since the current annual rent is significantly below market price. We do not believe that such an increase will be material to us.

Management believes that our present facilities are well maintained, in good condition and are sufficient for us to continue to operate and meet our production needs. Our utilization of our production capacity varies from time to time based on fluctuations in our business and other factors.

**Item 4A. Unresolved Staff Comments**

Not applicable.

**Item 5. Operating and Financial Review and Prospects**

*The following discussion of our results of operations should be read together with our consolidated financial statements and the related notes, which appear elsewhere in this annual report. The following discussion contains forward-looking* statements *that reflect our current plans, estimates and beliefs and involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this annual report.*

**Overview**

We were incorporated under the laws of the State of Israel in April 1985. We provide a variety of services and products to the aerospace industry, including the manufacture and sale of a broad range of heat transfer components used in mechanical and electronic systems on-board commercial and military aircraft and in a variety of other electronic equipment. Through our wholly-owned subsidiary, Limco-Piedmont Inc., we operate four FAA certified repair stations, which provide aircraft component MRO services for airlines, air cargo carriers, maintenance service centers and the military. In conjunction with its MRO services, Limco also manufactures related OEM components for airplane manufacturers and other environmental control and cooling systems. Piedmont s parts services division offers parts services for commercial, regional and charter airlines and business aircraft owners.

In July 2005, Limco acquired Piedmont for approximately $20.2 million, which includes $5.9 million in cash and the assumption of approximately $10.5 million of bank indebtedness and $3.7 million of other liabilities of Piedmont. The acquisition was accounted for using the purchase method of accounting as determined in FASB Statement No. 141 and accordingly, the purchase price was allocated to the assets acquired and the liabilities assumed based on the estimated fair value at the date of acquisition. Among the assets acquired from Piedmont, we allocated $11.3 million of the purchase price to current assets, $4.8 million to goodwill, $1.9 million to customer relationships, $1.2 million to property and equipment, $653,000 to non-compete agreements and $307,000 to other intangible assets.

After our acquisition of Piedmont, we initiated a broad cost-cutting initiative, which included:

- the consolidation of five business groups within Piedmont into three business groups which allowed us to reduce the number of Piedmont employees by 12% and to permit the lease of a Piedmont facility to lapse, reducing the number of facilities being utilized by Piedmont from three to two; and

- the replacement of $10.5 million of indebtedness bearing interest at an average rate of 8.17% with new debt bearing interest at an average rate of 6.34% as of June 30, 2005.

We believe that these actions resulted in savings of approximately $2 million to our company on an annual basis.

Our revenues and cost of revenues may vary significantly from year to year due to fluctuations in the mix of products ordered by customers and in the timing of orders and deliveries. As a result, comparisons of one period to another in any given year are not necessarily an accurate indication of future trends.

A substantial portion of our revenues is derived from the sale of products and services for the non-military market in the United States, Israel and Europe, nevertheless, our management believes that the success and development of our business will continue to depend in part upon our ability to participate in the defense programs of the United States, Israel and other governments. Certain of such defense programs have been reduced or terminated as a result of current political conditions and budgetary constraints; it is not possible to determine the extent to which such reductions have affected our revenues. These governments may not continue to commit to the current level of resources to such programs, we may not be able to continue to participate in such programs, and changes to such programs may materially affect our financial condition. As a result, our historical results of operations and financial position are not necessarily indicative of any future operating results or financial position.

**General**

Our consolidated financial statements appearing in this annual report are prepared in U.S. dollars and in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. All references in this annual report to dollars or $ are to U.S. dollars and all references in this annual report to NIS are to New Israeli Shekels. Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in other currencies are remeasured into dollars in accordance with the principles set forth in Financial Accounting Standards Board Statement No. 52. The majority of our sales are made outside Israel in dollars. In addition, substantial portions of our costs are incurred in dollars. Since the dollar is the primary currency of the economic environment in which we and our subsidiaries operate, the dollar is our functional and reporting currency and, accordingly, monetary accounts maintained in currencies other than the dollar are remeasured using the foreign exchange rate at the balance sheet date. Operational accounts and non-monetary balance sheet accounts are measured and recorded at the exchange rate in effect at the date of the transaction. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of shareholders equity in accumulated other comprehensive income (loss).

**Sources of Revenues**

We specialize in the manufacture and sale of a broad range of heat transfer components used in mechanical and electronic systems on-board commercial and military aircraft and in the repair and overhaul of heat transfer components, APUs, propellers, landing gear and pneumatic ducting. We are licensed by Hamilton Sundstrand, a leading provider of aerospace products, to provide MRO services for all of their air-to-air heat transfer products, by Honeywell, a leading manufacturer of aerospace products and aerospace services provider, to provide MRO services for three of their APU models. Our propeller repair facility is an authorized service center for Hartzell and McCauley propellers. Our repair stations are certified by the FAA and the EASA. We also manufacture heat transfer components used in commercial, regional, business and military aircraft, complete environmental control systems and cooling systems for electronics.

Our parts services division provides inventory management and parts services for commercial, regional and charter airlines and business aircraft owners. We also maintain a small inventory of parts for resale.

The following table reflects the geographic breakdown of our revenues for each of the three years ended December 31, 2006:

| | Years Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2005(1) | | 2004 | |
| | Revenues in Thousands | % of Total Revenues | Revenues in Thousands | % of Total Revenues | Revenues in Thousands | % of Total Revenues |
| Sources of Revenues | | | | | | |
| North America | $ 51,292 | 66.2% | $ 30,495 | 62.0% | $ 17,569 | 52.9% |
| Europe | 15,210 | 19.6% | 11,256 | 22.9% | 8,736 | 26.3% |
| Israel. | 7,042 | 9.1% | 4,122 | 8.4% | 5,095 | 15.3% |
| Asia | 1,953 | 2.5% | 1,983 | 4.0% | 1,430 | 4.3% |
| Other | 2,036 | 2.6% | 1,337 | 2.7% | 413 | 1.2% |
| Total | $ 77,533 | 100.00% | $ 49,193 | 100.00% | $ 33,243 | 100.00% |

(1) Includes the operations of Piedmont since its acquisition in July 2005.

Our revenues from our three principal lines of business for the three years ended December 31, 2006 were as follows:

| | Years Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2005(1) | | 2004 | |
| | Revenues in Thousands | % of Total Revenues | Revenues in Thousands | % of Total Revenues | Revenues in Thousands | % of Total Revenues |
| Revenues: | | | | | | |
| MRO services | $ 43,824 | 56.5% | $ 27,733 | 56.4% | $ 14,105 | 37.7% |
| OEM products | 18,512 | 23.9% | 17,405 | 35.4% | 19,138 | 62.3% |
| Parts services (2) | 15,197 | 19.6% | 4,055 | 8.2% | | |
| Total revenues | $ 77,533 | 100.00% | $ 49,193 | 100.00% | $ 33,243 | 100.00% |

(1) Includes the operations of Piedmont since its acquisition in July 2005.

(2) Prior to the acquisition of Piedmont in July 2005 parts services revenues were an incidental part of our business.

**Costs and Expenses**

***Cost of revenues.*** Our cost of revenues for OEM manufacturing consists of our cost of revenues for MRO services consists of component and material costs, direct labor costs, shipping expenses, overhead related to manufacturing and depreciation of manufacturing equipment. Our cost of revenues for parts services consists primarily of the cost of the parts and shipping expenses.

Our gross margin is affected by the proportion of our revenues generated from MRO services (including the sale of OEM products) and parts services. Our revenues from MRO services generally have higher gross margins than our parts services.

***Selling and marketing expenses.*** Selling and marketing expenses consist primarily of commission payments, compensation and related expenses of our sales teams, attendance at trade shows and advertising expenses and related costs for facilities and equipment.

***General and administrative expenses.*** General and administrative expenses consist of compensation and related expenses for executive, finance, legal and administrative personnel, professional fees and other general corporate expenses and related costs for facilities and equipment.

***Financial income (expense), net.*** Financial income (expense), net consists of our income and interest expense . Our interest expense relates to the interest paid to Bank Leumi and changes in the rate of the NIS against the U.S. dollar

***Other income.*** Other income results from our sale of marketable securities and equipment.

***Tax expense.*** Tax expense consists of Israeli, U.S. federal, state and local taxes on the income of our business.

**Impact of Critical Accounting Policies**

Our consolidated financial statements are prepared in accordance with U.S. GAAP. These accounting principles require management to make certain estimates, judgments and assumptions based upon information available at the time that they are made, historical experience and various other factors that are believed to be reasonable under the circumstances. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. While all the accounting policies impact the financial statements, certain policies may be viewed to be critical. These policies are those that are both most important to the portrayal of our financial condition and results of operations and require our management s most difficult, subjective and complex judgments and estimates. Actual results could differ from those estimates.

In many cases, the accounting treatment of a particular transaction is specifically dictated by generally accepted accounting principles in the United States and does not require management s judgment in its application. There are also areas in which management s judgment in selecting among available alternatives would not produce a

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materially different result. Our management has reviewed these critical accounting policies and related disclosures with the Audit Committee.

Our management believes the significant accounting policies which affect management s more significant judgments and estimates used in the preparation of our consolidated financial statements and which are the most critical to aid in fully understanding and evaluating the our reported financial results include revenue recognition and inventory valuation.

*Segments*

In 2005, following the acquisition of Piedmont, there was a change in our reported segments. Accordingly, commencing 2005, we began to report based on two segments: (1) MRO and OEM and (2) parts, compared to one reportable segment in 2004. During 2006, due to a reorganization of the group and the decision to seek equity financing through an initial public offering of Limco-Piedmont Inc., we now manage our segments on the basis of three reportable segments: (1) OEM (2) MRO and (3) parts, and we follow the requirements of SFAS No. 131 Disclosures About Segments of an Enterprise and Related Information ( SFAS No. 131 ).

The segment disclosure for 2005 was restated to reflect retroactively the effect of reporting based on three segments to be in conformity to our 2006 disclosure. (See Note 1a for a brief description of the Company s business)

The Company s three reporting segments are as follows:

- OEM - focuses on the manufacture of heat transfer equipment such as heat exchangers, precoolers and oil/fuel hydraulic coolers used in aircraft, defense systems, electronic equipment and other applications. In addition, we manufacture aircraft accessories and systems such as pumps, valves, power systems, turbines, etc.;
- MRO - focuses on the remanufacture, overhaul and repair of heat transfer equipment and other aircraft components and of repair of APUs, propellers and landing gear; and
- Parts - focuses on the sale of APU, propeller and landing gear parts.

**Revenue recognition**

Revenues from the sale of our products and services are recognized when persuasive evidence of an arrangement exists, delivery of the product has occurred, provided the collection of the resulting receivable is probable, the price is fixed or determinable and we no longer have any significant obligation with respect to such sale. We do not grant a right of return. Revenue from remanufacture, repair and overhaul services are recognized as services are performed.

Revenues from maintenance contracts are recognized over the contract period in proportion to the costs expected to be incurred in performing services under the contract. We estimate the costs that are expected to be incurred based on our experience with the aggregate costs incurred and to be incurred on contracts of this nature. The costs incurred related to our maintenance contracts are not incurred on a straight-line basis, as the timing to provide our maintenance services is dependent on when parts under these contracts require maintenance.

**Goodwill, Other Intangible Assets and Long-Lived Assets**

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations. Of the $7.1 million of goodwill on our balance sheet as of December 31, 2006, approximately $4.3 million was a result of the acquisition of Piedmont. The identifiable intangible assets relating to the Piedmont acquisition, other than goodwill, included in our balance sheet are workforce, customer relationships and other assets acquired. The value we assigned to these intangible assets, using the income approach based on the present value of the cash flows attributable to each asset, was approximately $2.9 million. The amounts allocated to these intangible assets are being amortized on a straight-line basis over periods ranging from 0.3 to 10 years.

We review goodwill and other intangible assets for potential impairment annually and when events or changes in circumstances indicate the carrying value of the goodwill or the other intangible assets may be impaired, in which case we may obtain an appraisal from an independent valuation firm to determine the amount of impairment, if any. In addition to the possible use of an independent valuation firm, we perform internal valuation analyses and consider other publicly available market information. We determine fair value using widely accepted valuation techniques, including discounted cash flow and market multiple analyses. These types of analyses require us to make assumptions and estimates regarding industry economic factors and the profitability of future business strategies. It is our policy to conduct impairment testing based on our current business strategy in light of present industry and economic conditions, as well as future expectations. In the fourth quarter of fiscal 2006, we completed our annual impairment testing of goodwill using the methodology described in the notes to our consolidated financial statements, and determined there was no impairment of our goodwill. If actual results are not consistent with our assumptions and estimates, we may be exposed to a goodwill impairment charge.

**Income Taxes**

We operate within multiple taxing jurisdictions and are subject to audits in these jurisdictions. These audits can involve complex issues, which may require an extended period of time to resolve. In management s opinion, adequate provisions for income taxes have been made for all years. Although management believes that its estimates are reasonable, no assurance can be given that the final tax outcome of these issues will not be different than those that are reflected in our historical income tax provisions.

We account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, ( SFAS No. 109 ). We use the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement and tax bases of assets and liabilities and net operating loss and credit carry forwards using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when it is more likely than not that some portion of the deferred tax assets will not be realized. To the extent that our decisions and assumptions and historical reporting are determined not to be compliant with applicable tax laws we may be subject to adjustments in our reported income for tax purposes as well as interest and penalties.

**Allowances for Doubtful Accounts**

We perform ongoing credit evaluations of our customers financial condition and we require collateral as deemed necessary. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments. In judging the adequacy of the allowance for doubtful accounts, we consider multiple factors including the aging of our receivables, historical bad debt experience and the general economic environment. Management applies considerable judgment in assessing the realization of receivables, including assessing the probability of collection and the current credit worthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

**Inventories**

Inventories are stated at the lower of cost or market. Cost is determined by the average cost and first-in, first-out (FIFO) methods. Our policy for valuation of inventory and commitments to purchase inventory, including the determination of obsolete or excess inventory, requires us to perform a detailed assessment of inventory at each balance sheet date which includes a review of, among other factors, an estimate of future demand for products within specific time frames, valuation of existing inventory, as well as product lifecycle and product development plans. The business environment in which we operate, the wide range of products that we offer and the relatively short sales-cycles we experience all contribute to the exercise of judgment relating to maintaining and writing-off of inventory levels. The estimates of future demand that we use in the valuation of inventory are the basis for our revenue forecast, which is also consistent with our short-term manufacturing plan. Inventory reserves are also provided to cover risks arising from non-moving items. Inventory management remains an area of management focus as we balance the need to maintain strategic inventory levels to ensure competitive lead times against the risk of inventory obsolescence because of rapidly changing technology and customer requirements. We write down obsolete or slow moving inventory in an amount equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand, market conditions and sale forecasts. If actual market conditions are less favorable than we anticipate, additional inventory write-downs may be required.

**Warranty Costs**

We provide warranties for our products and services ranging from one to five years, which vary with respect to each contract and in accordance with the nature of each specific product. We estimate the costs that may be incurred under our warranty and record a liability in the amount of such costs at the time the product is shipped. We periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary. As of December 31, 2006 and 2005, the aggregate amount of our warranty costs was not material.

**Marketable securities**

Marketable securities consist of available for sale securities, which are debt securities in which we invested with the intention of holding until the maturity dates of such securities. If it is determined, based on valuations, that a decline in the fair value of any of the investments is not temporary, an impairment loss is recorded and included in the consolidated statements of income as financial expenses.

**Key Indicators**

Our management evaluates our performance by focusing on our key performance indicators, which are our revenues, sources of revenues, gross profit, and operating income. These key performance indicators are primarily affected by the competitive landscape in which we operate and our ability to meet the challenges posed. Our management believes that the upward trend in our revenues is reflective of an industry-wide increase in demand for MRO services, and we currently expect that this trend will continue for the foreseeable future. While our management believes that demand for parts services will also continue to grow, this segment is subject to a high degree of volatility because of the potential impact of large one time parts purchases. We expect that the mix of our revenues will return to former levels over the course of the remainder of this year.

**A. Operating Results**

The following table presents, for the periods indicated, information concerning our results of operations:

| | Year ended December 31 | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| | | (in thousands) | |
| Revenues | | | |
| MRO services | $ 43,824 | $ 27,733 | $ 14,105 |
| OEM products | 18,512 | 17,405 | 19,138 |
| Parts services | 15,197 | 4,055 | |
| Total revenues | 77,533 | 49,193 | 33,243 |
| Cost of revenues | | | |
| MRO services | 32,214 | 21,514 | 10,607 |
| OEM products | 12,590 | 11,266 | 11,559 |
| Parts services | 12,835 | 2,812 | |
| Total cost of revenues | 57,639 | 35,592 | 22,166 |
| Research and development costs, net | | 72 | 125 |
| Sales and marketing expenses | 3,466 | 2,495 | 1,894 |
| General and administrative expenses | 6,710 | 5,138 | 3,793 |
| Operating income | 9,718 | 5,896 | 5,265 |
| Financial income (expenses), net | (464) | (441) | 87 |
| Other income | 59 | 210 | 54 |
| Income before income taxes | 9,313 | 5,665 | 5,406 |
| Income taxes | 3,247 | 2,136 | 1,667 |
| Net income | $ 6,066 | $ 3,529 | $ 3,739 |

The following table presents, for the periods indicated, information concerning our results of operations as a percentage of our revenues:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Revenues | | | |
| OEM products | 56% | 56% | 42% |
| MRO services | 24 | 35 | 58 |
| Parts services | 20 | 8 | |
| Total revenues | 100 | 100 | 100 |
| Cost of revenues | | | |
| OEM products | 41 | 43 | 32 |
| MRO services | 16 | 23 | 35 |
| Parts services | 17 | 6 | |
| Cost of revenues | 74 | 72 | 67 |
| Research and development, net | | * | * |
| Sales and marketing expenses | 4 | 5 | 6 |
| General and administrative expenses | 9 | 11 | 11 |
| Operating income | 13 | 12 | 16 |
| Financial income (expenses) , net | (1) | (1) | * |
| Other income | * | * | * |
| Income before income taxes | 12 | 11 | 16 |
| Income taxes | 4 | 4 | 5 |
| Net income | 8% | 7% | 11% |

* Less than one percent.

**Year Ended December 31, 2006 Compared with Year Ended December 31, 2005**

*Revenues.* Total revenues increased to $77.5 million for the year ended December 31, 2006 from $49.2 million for the year ended December 31, 2005, an increase of 57.5%. This increase was primarily attributable to the inclusion of a full year of revenues generated by our Piedmont subsidiary that was acquired in July 2005. In 2005, we included $16.1 million in revenues attributable to Piedmont while in 2006 Piedmont generated $42.3 million of revenues.

Revenues from MRO services increased to $43.8 million for the year ended December 31, 2006 from $27.7 million for the year ended December 31, 2005, an increase of 58.1%. The increase in MRO services revenues in the year ended December 31, 2006 was primarily attributable to the $27 million of MRO services revenues generated by Piedmont in 2006 compared to $12.2 million generated by it in the second half of 2005 after its acquisition. The organic growth in our MRO services segment is primarily a result of increased sales to Piedmont s existing customers and sales to new customers.

Revenues from OEM sales increased to $18.5 million for the year ended December 31, 2006 from $17.4 million for the year ended December 31, 2005, an increase of 6.3%. The organic growth in our OEM product revenues is primarily a result of increased sales to existing customers, including to Limco-Piedmont.

Parts services revenues increased by 274.7% to $15.2 million for the year ended December 31, 2006 from $4.1 million for the year ended December 31, 2005, when we acquired the parts business of Piedmont. The organic growth in parts sales is attributable to increased purchases by Piedmont s existing customers and the recruitment of four new customers that required parts for the general overhaul of their aircraft.

*Cost of revenues.* Cost of revenues increased to $57.6 million for the year ended December 31, 2006 from $35.6 million for the year ended December 31, 2005, an increase of 61.9%, principally as a result of the inclusion of the costs associated with Piedmont s revenues. We expect that our cost of revenues will increase in 2007 consistent with the expected increase in our revenues.

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*Cost of revenues MRO services.* Cost of revenues increased to $32.2million for the year ended December 31, 2006 from $21.5 million for the year ended December 31, 2005, an increase of 49.7%, principally as a result of the inclusion of the costs associated with Piedmont s revenues. We expect that our cost of revenues will increase in 2007 consistent with the expected increase in our revenues.

*Cost of revenues OEM products.* Cost of revenues increased to $12.6 million for the year ended December 31, 2006 from $11.3 million for the year ended December 31, 2005, an increase of 11.8%, principally as a result of Increase in revenues. We expect that our cost of revenues will increase in 2007 consistent with the expected increase in our revenues.

*Cost of revenues parts services.* Cost of revenues increased to $12.8 million for the year ended December 31, 2006 from $2.8 million for the year ended December 31, 2005, an increase of 356.4%, principally as a result of the inclusion of the costs associated with Piedmont s revenues. We expect that our cost of revenues will increase in 2007 consistent with the expected increase in our revenues.

*Research and development net.* We did not incur any research and development expenses in the year ended December 31, in 2006 while we incurred $72,000 in research development expenses in the year ended December 31, 2005. We do not expect to incur any significant research and development expenses in 2007.

*Selling and marketing expenses.* Selling and marketing expenses increased to $3.5 million for the year ended December 31, 2006 from $2.5 million for the year ended December 31, 2005, an increase of 38.91%. The increase in our selling and marketing expenses is mainly due to the purchase of Piedmont in July 2005. Our selling and marketing expenses as a percentage of revenues increased to 4.5% for the year ended December 31, 2006 from 5.1% for the year ended December 31, 2005. We expect that our selling and marketing expenses will increase in 2007 consistent with the expected increase in our revenues.

*General and administrative expenses.* General and administrative expenses increased to $6.7 million for the year ended December 31, 2006 from $5.1 million for the year ended December 31, 2005, an increase of 30.6%. General and administrative expenses as a percentage of revenues decreased to 8.6% for the year ended December 31, 2006 from 10.4% for the year ended December 31, 2005, primarily as a result of our reorganization of Piedmont s operational structure from five business units to three business units and management s efforts to streamline the number of levels of management at Piedmont after the acquisition. We expect that our general and administrative expenses will increase in 2007 as we incur costs associated with establishing the required controls necessary to be in compliance with the Sarbanes-Oxley Act and with our expected growth in operations.

*Operating income.* Operating income in the year ended December 31, 2006 increased 64.8% to $9.7 million, or 12.5% of revenues, compared to $5.8 million in the year ended December 31, 2005 or 12.0% of revenues.

*Financial income (expenses), net*. We incurred financial expenses of $464,000 in the year ended December 31, 2006 compared to financial expenses of $441,000 in the year ended December 31, 2005. These interest expenses relate to the loans we incurred in connection with the purchase of Piedmont. We believe that our financial expenses will decline in 2007 because of our expected repayment in mid-year of the outstanding debt incurred in connection with the purchase of Piedmont.

*Other Income*. We had other income of $59,000 in the year ended December 31, 2006 compared to other income of $210,000 in the year ended December 31, 2005. Other income resulted from our sale of marketable securities and equipment.

*Income taxes*. Our total income tax expense for the year ended December 31, 2006 amounted to $3.2 million, compared to $2.1 million in the year ended December 31, 2005. As a result of the increased profitability of our subsidiaries in the U.S., our effective tax rate increased in the year ended December 31, 2006 to 34.8% from 37.7% in the year ended December 31, 2005. This increase in taxes in the U.S. was offset in part by the decrease in the statutory tax rate in Israel, from 34% in the year ended December 31, 2005 to 31% in the year ended December 31, 2006.

*Net income*. In the year ended December 31, 2006, we had net income of $6.1 million, compared with net income of $3.5 million in the year ended December 31, 2005.

**Year Ended December 31, 2005 Compared with Year Ended December 31, 2004**

*Revenues.* Our revenues increased 48.0% to $49.2 million in the year ended December 31, 2005 from $33.2 million in the year ended December 31, 2004. The increase in our revenues in the year ended December 31, 2005 is mainly due to the purchase of Piedmont in July 2005. We included Piedmont revenues for the six-month period after its acquisition in our 2005 financial statements. In the year ended December 31, 2005, we had revenues of $45.2 million from OEM manufacturing and revenues of $4.0 million from the sale of parts, compared to $33.2 million in revenues from MRO Services and OEM parts in the year ended December 31, in 2004. Parts services revenues were incidental to our business prior to our acquisition of Piedmont.

*Cost of Revenues*. Cost of revenues increased 60% to $35.5 million in the year ended December 31, 2005 from $22.2 million in the year ended December 31, 2004, representing, 72% and 67% of revenues, respectively. The increase in cost of revenues is mainly due to the costs associated with revenues of Piedmont in the second half of 2005.

*Gross Profit*. Gross profit increased 22.8% to $13.6 million in the year ended December 31, 2005 from $11.1 million in the year ended December 31, 2004. The increase in our gross profit in 2005 is mainly due to the purchase of Piedmont in July 2005.

*Research and development costs*. Our research and development costs decreased 43% to $72,000 in December 31, 2005, compared to $125,000 in the year ended December 31, 2004.

*Selling and marketing expenses*. Selling and marketing expenses increased 31% to $2.5 million in the year ended December 31, 2005 from $1.9 million in the year ended December 31, 2004, representing 5.1% and 5.7% of our revenues, respectively. The increase in our selling and marketing expenses in the year ended December 31, 2005 was mainly due to the inclusion of Piedmont s selling and marketing expenses of $590,000.

*General and Administrative Expenses*. General and administrative expenses increased 35.2% to $5.1 million in the year ended December 31, 2005 from $3.8 million in the year ended in December 31, 2004, representing 10.4% and 11.4% of revenues, respectively.The increase in our general and administrative expenses in the year ended December 31, 2005 was mainly due to Piedmont s general and administrative expenses of $1.74 million.

*Operating income.* Operating income in the year ended December 31, 2005 increased 9.4% to $5.8 million, or 10.4% of revenues, compared to $5.3 million in the year ended December 31, 2004 or 11.4% of revenues.

*Financial income (expenses), net*. We incurred financial expenses of $441,000 in the year ended December 31, 2005 compared to financial income of $87,000 in the year ended December 31, 2004, as a result of the interest expenses associated with the loans we incurred in connection with the purchase of Piedmont.

*Other Income*. We had other income of $210,000 in the year ended December 31, 2005 compared to other income of $54,000 in the year ended December 31, 2004. Other income in the year ended December 31, 2005 resulted from the sale of marketable securities and equipment.

*Income taxes*. Our total income tax expenses for the year ended December 31, 2005 amounted to $2.1 million, compared to $1.7 million in the year ended December 31, 2004. As a result of the increased profitability of our subsidiaries in the U.S., our effective tax rate increased in the year ended December 31, 2005 to 37.7% from 30.8% in the year ended December 31, 2005.

*Net income*. In the year ended December 31, 2005, we had net income of $3.5 million, compared with net income of $3.7 million in the year ended December 31, 2004.

**Quarterly Results of Operations**

The following table presents the consolidated statements of operations data for each of the eight fiscal quarters ended December 31, 2006, in dollars and as a percentage of revenues. In management s opinion, this unaudited information has been prepared on the same basis as our audited consolidated financial statements and includes all adjustments, consisting only of normal recurring adjustments, necessary for fair presentation of the unaudited information for the quarters presented. The results of operations for any quarter are not necessarily indicative of results that we might achieve for any subsequent periods.

| | Three months ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | | | 2005 | | | |
| | Mar. 31, | June 30, | Sept. 30, | Dec. 31, | Mar. 31, | June 30, | Sept. 30, | Dec. 31, |
| | (in thousands) | | | | | | | |
| Revenues | $ 16,407 | $ 18,390 | $ 18,977 | $ 23,759 | $ 8,389 | $ 8,961 | $ 14,403 | $ 17,440 |
| Cost of revenues | 11,916 | 13,543 | 13,776 | 18,404 | 5,737 | 5,837 | 10,561 | 13,457 |
| Gross profit | 4,491 | 4,847 | 5,201 | 5,355 | 2,652 | 3,124 | 3,842 | 3,983 |
| Research and development, net | | | | | 17 | 22 | 15 | 18 |
| Sales and marketing expenses | 780 | 832 | 845 | 1,009 | 465 | 558 | 620 | 852 |
| General and administrative expenses | 1,561 | 1,767 | 1,729 | 1,653 | 985 | 1,091 | 1,617 | 1,445 |
| Operating income | 2,150 | 2,248 | 2,627 | 2,693 | 1,185 | 1,453 | 1,591 | 1,667 |
| Financial expenses, net | (108) | (140) | (78) | (139) | (1) | (5) | (308) | (127) |
| Other income | 2 | 23 | 7 | 27 | 21 | 118 | 72 | (1) |
| Income before income taxes | 2,044 | 2,131 | 2,556 | 2,582 | 1,205 | 1,566 | 1,354 | 1,540 |
| Income taxes | 789 | 650 | 881 | 927 | 417 | 668 | 494 | 557 |
| Net income | $ 1,255 | $ 1,481 | $ 1,675 | $ 1,655 | $ 788 | $ 898 | $ 860 | $ 983 |
| Revenues | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of revenues | 72.6 | 73.6 | 72.6 | 77.5 | 68.4 | 65.1 | 73.3 | 77.2 |
| Gross profit | 27.4 | 26.4 | 27.4 | 22.5 | 31.6 | 34.9 | 26.7 | 22.8 |
| Research and development net | | | | | 0.2 | 0.3 | 0.1 | 0.1 |
| Sales and marketing expenses | 4.8 | 4.5 | 4.5 | 4.2 | 5.5 | 6.2 | 4.3 | 4.9 |
| General and administrative expenses | 9.5 | 9.6 | 9.1 | 7.0 | 11.7 | 12.2 | 11.2 | 8.3 |
| Operating income | 13.1 | 12.2 | 13.9 | 11.3 | 14.1 | 16.2 | 11.1 | 9.6 |
| Financial expenses, net | (0.7) | (0.8) | (0.4) | (0.5) | 0 | 0 | (2.1) | (0.7) |
| Other income | 0.0 | 0.1 | 0.0 | 0.1 | 0.3 | 1.3 | 0.5 | 0 |
| Income before income taxes | 12.5 | 11.6 | 13.5 | 10.9 | 14.4 | 17.4 | 9.4 | 8.8 |
| Income taxes | 4.8 | 3.5 | 4.6 | 3.9 | 5.0 | 7.4 | 3.4 | 3.2 |
| Net income | 7.7% | 8.1% | 8.8% | 7.0% | 9.4% | 10.0% | 6.0% | 5.6% |

We expect our operating results to fluctuate significantly in the future as a result of various factors, many of which are outside our control, including the timing of orders, the provision of services and deliveries. Consequently, we believe that period-to-period comparisons of our operating results may not necessarily be meaningful, and as a result, you should not rely on them as an indication of future performance.

**Seasonality**

We believe that the growth of our business over the last two years has masked a historical seasonal trend in the MRO services sector. Historically, we have seen many airlines decrease their maintenance requirements in the peak air travel summer months and increase their maintenance requirements in the winter months when air travel is not as great.

**Conditions in Israel**

We are incorporated under the laws of, and our principal executive offices and manufacturing and research and development facilities are located in, the State of Israel. Accordingly, we are directly affected by political, economic and military conditions in Israel. Specifically, we could be adversely affected by any major hostilities involving Israel, a full or partial mobilization of the reserve forces of the Israeli army, the interruption or curtailment of trade between Israel and its present trading partners, and a significant downturn in the economic or financial condition of Israel.

**Political Conditions**

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, there has been an increase in unrest and terrorist activity in Israel, which began in September 2000 and which has continued with varying levels of severity through 2006. In July 2006, an armed conflict began between Israel and Hezbollah forces in Lebanon, which involved rocket attacks on populated areas in the northern parts of Israel. On August 14, 2006, a cease-fire between Hezbollah and Israel took effect. This situation has had an adverse effect on Israel s economy, primarily in the geographical areas directly harmed by this conflict. Any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. No predictions can be made as to whether or when a final resolution of the area s problems will be achieved or the nature thereof and to what extent the situation will impact Israel s economic development or our operations.

Furthermore, there are a number of countries, primarily in the Middle East, as well as Malaysia and Indonesia, that restrict business with Israel or Israeli companies, and we are precluded from marketing our products to these countries. Restrictive laws or policies directed towards Israel or Israeli businesses may have an adverse impact on our operations, our financial results or the expansion of our business.

In addition, some of our executive officers and employees in Israel are obligated to perform annual reserve duty in the Israeli Defense Forces and may be called for active duty under emergency circumstances at any time. If a military conflict or war arises, these individuals could be required to serve in the military for extended periods of time. Our operations could be disrupted by the absence for a significant period of one or more of our executive officers or key employees or a significant number of other employees due to military service. Any disruption in our operations could adversely affect our business.

**Trade Relations**

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

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

**Impact of Currency Fluctuation and of Inflation**

The dollar cost of our operations is influenced by the extent to which any inflation in Israel is offset on a lagging basis, or is not offset by the devaluation of the NIS in relation to the dollar. When the rate of inflation in Israel exceeds the rate of devaluation of the NIS against the dollar, companies experience increases in the dollar cost of their operations in Israel. Unless offset by a devaluation of the NIS, inflation in Israel will have a negative effect on our profitability as we receive payment in dollars or dollar-linked NIS for all of our sales while we incur a portion of our expenses, principally salaries and related personnel expenses, in NIS.

The following table presents information about the rate of inflation in Israel, the rate of devaluation (appreciation) of the NIS against the U.S. dollar, and the rate of inflation of Israel adjusted for the devaluation (appreciation):

| Year ended December 31, | Israeli inflation rate% | Israeli devaluation (appreciation rate%) | Israeli inflation adjusted for devaluation% |
|---|---|---|---|
| 2002 | 6.5 | 7.3 | (0.8) |
| 2003 | (1.9) | (7.6) | 5.8 |
| 2004 | 1.2 | (1.6) | 2.8 |
| 2005 | 2.4 | 6.8 | (4.3) |
| 2006 | (0.1) | (8.2) | 8.1 |

We cannot assure you that we will not be materially and adversely affected in the future if inflation in Israel exceeds the devaluation of the NIS against the dollar or if the timing of the devaluation lags behind inflation in Israel.

A devaluation of the NIS in relation to the dollar has the effect of reducing the dollar amount of any of our expenses or liabilities which are payable in NIS, unless these expenses or payables are linked to the dollar. This devaluation also has the effect of decreasing the dollar value of any asset which consists of NIS or receivables payable in NIS, unless the receivables are linked to the dollar. Conversely, any increase in the value of the NIS in relation to the dollar has the effect of increasing the dollar value of any unlinked NIS assets and the dollar amounts of any unlinked NIS liabilities and expenses.

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

**Corporate Tax Rate**

Israeli companies are generally subject to income tax on their taxable income. The applicable rate for 2006 was 31%, which was reduced to 29% in 2007, and will be further reduced to 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

However, because we have elected to participate in the alternative package of tax benefits for our current approved enterprise, the income derived from that enterprise will be exempt from Israeli corporate tax for a specified benefit period (except to the extent that dividends are distributed during the tax-exemption period other than upon liquidation) and subject to reduced corporate tax rates for an additional period. The period of tax benefits for our approved enterprise expires in 2012. Certain investment income derived by us from investments may not be regarded by the Israeli tax authorities as income from its approved enterprise and consequently may be taxed at the regular statutory rate in Israel.

Our non-Israeli. subsidiaries are taxed based on the tax laws in its country of residence, the tax rate for our U.S. subsidiaries is approximately 38%.

**B. Liquidity and Capital Resources**

**General**

From our inception until our initial public offering in March 1987, we financed our activities mainly through cash flow from operations and bank loans. In March 1987, we received proceeds of $4,025,000 from an initial public offering of 268,333 ordinary shares. In October 1993 we raised $27,183,153 from a follow-on offering of 1,599,009 ordinary shares.

On June 15, 2004, we entered into a share purchase agreement with Ta-Top, a wholly-owned subsidiary of Ta-Tek Ltd., an Israeli private company wholly-owned by FIMI Opportunity Fund or FIMI. Under the share purchase agreement we sold 857,143 of our shares to Ta-Top for $6,000,001. We also granted Ta-Top warrants to purchase an aggregate of 500,000 of our ordinary shares at $8.50 per share, which price was adjusted to $6.94 per share because of our 2004, 2005 and 2006 dividend payments. The warrants were exercised on February 21, 2007. In addition, we entered into a credit line agreement with FIMI, which provided for a line of credit in an amount of up to $2 million. In September 2006, we notified FIMI of our cancellation of the credit line. We also entered into a management agreement with FIMI which provides that we will engage FIMI to provide certain management services to us in exchange for annual payments equal to 3% of our operating profit exceeding $500,000; provided, however, that in no event will the total management fees in any given year exceed $250,000. The agreements were approved by our shareholders on August 10, 2004.

We had cash and cash equivalents and short-term investments of $7.3 million as of December 31, 2006, as compared with cash and cash equivalents and short-term investments of $7.5 million and marketable securities of $300,000, totaling $7.8 million as of December 31, 2005.

In July 2005, our U.S. subsidiary acquired Piedmont for approximately $20.2 million, which included the assumption of approximately $8.7 million of indebtedness and $5.6 million of other liabilities of Piedmont. We repaid the assumed indebtedness with the proceeds from $12 million of bank loans. The remaining proceeds of these loans, along with $3.0 million of our cash, were used to pay the $5.3 million purchase price and a portion of the assumed liabilities. The remainder of the assumed liabilities were funded through cash flows from subsequent operations.

We incurred $6 million in long-term debt from Bank Leumi Israel for a period of five years, through two loans for the purchase of Piedmont. The loans are to be repaid in three equal annual installments and the first payment is due on July 1, 2008. One of the loans bears interest of Libor + 1% and the second loan bears annual interest of 5.25%. Interest installments under both loans are paid quarterly. Under the terms of the loans we are required to maintain consolidated shareholders equity of not less than $15 million. In August 2006, we repaid $2 million on behalf of the first loan

After our purchase of Piedmont, Piedmont incurred $6 million in long term debt from Bank Leumi USA. The two year loan bears an annual interest of Libor + 1.3%. Under the terms of the loan Piedmont is required to maintain a ratio of funded debt to EBITDA of not more than 3.25 to 1, a fixed charge coverage ratio of at least 2.5 to 1 and net profit of not less than $1 million. In addition, we as the guarantor may not pay dividends without the prior written consent of the bank. In each of the years 2006 and 2005, Piedmont repaid $1 million of this loan amount.

As of December 31, 2006, we were in compliance with all required financial covenants. We expect that both loans incurred for the purchase of Piedmont will be repaid in 2007 with the proceeds from the proposed initial public offering of Limco-Piedmont.

We believe that anticipated cash flow from operations and our current cash balances will be sufficient to meet our cash requirements for at least 12 months. Our continued operations thereafter will depend upon cash flow from operations and the availability of equity or debt financing.

Capital expenditures for the years ended December 31, 2004, 2005 and 2006 were approximately $925,000, $6.3 million, and $1.7 million, respectively. These capital expenditures were principally for the purchase of equipment for our OEM and MRO facilities. We funded these expenditures from our cash flow from operations. We expect that our capital expenditures for 2007 will total $1.5 million, primarily for expanded capabilities and capacity for our OEM and MRO services. We expect that our cash flow from operations will be sufficient to fund these capital expenditures.

Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our selling and marketing activities, costs associated with expansion into new markets, the timing of the introduction of new products and services.

**Cash Flows**

The following table summarizes our cash flows for the periods presented:

| | Year ended December 31, (in thousands) | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Net cash provided by (used in) operating activities | $ 5,153 | $ 4,140 | $ 1,908 |
| Net cash used in investing activities | (2,283) | (5,511) | 1,312 |
| Net cash provided by (used in) financing activities | (4,091) | 1,276 | (1,209) |
| Net (decrease) increase in cash and cash equivalents | (1,221) | (95) | 2,011 |
| Cash and cash equivalents at beginning of period | 6,983 | 7,078 | 5,067 |
| Cash and cash equivalents at end of period | $ 5,762 | $ 6,983 | $ 7,078 |

Net cash provided by operating activities was approximately $5.2 million, $4.1 million and $1.9 million in the years ended December 31, 2006, 2005 and 2004, respectively. Net cash provided by operating activities in the year ended December 31, 2006 was primarily attributable to net income of $6.1 million, depreciation and amortization of $1.8 million, and an increase in other accounts payable and accrued expenses of $510,000, which was offset by a $2.7 million increase in trade receivables, a $2.6 million increase in trade payables and a $2.5 million increase in inventories. Net cash provided by operating activities in the year ended December 31, 2005 was primarily attributable to net income of $3.5 million, depreciation and amortization of $1.4 million, a decrease in trade receivables of $1.1 million and an increase in other accounts payable and accrued expenses of $445,000, which was offset by an increase in inventories of $1.4 million and a decrease in trade payables of $1.0 million. Net cash provided by operating activities in the year ended December 31, 2004 was primarily attributable to net income of $3.7 million and depreciation and amortization of $1.0 million, which was offset by an increase in trade receivables of $1.6 million and a decrease in other accounts payable and accrued expenses of $1.2 million.

Net cash used in investing activities was approximately $2.3 million for the year ended December 31, 2006, compared to net cash used in investing activities of approximately $5.5 million for the year ended December 31, 2005, and to net cash provided by investing activities of approximately $1.3 million for the year ended December 31, 2004. Cash was used in the year ended December 31, 2006 mainly for the purchase of $1.7 million of property and equipment, and bank deposits of $1.0 million. Net cash used in investing activities was $5.5 million in the year ended December 31, 2005, primarily for the acquisition of Piedmont. In the year ended December 31, 2004, $1.3 million of cash was provided by investing activities, resulting from the sale of marketable securities and short-term deposits.

In the year ended December 31, 2006, net cash used in financing activities of $4.1 million was primarily attributable to our payment of a cash dividend of $1.2 million and the repayment of $3.0 million of long-term loans. In the year ended December 31, 2005, net cash provided by financing activities of $1.3 million was primarily attributable to an increase in proceeds from long-term loans $12.0 million used in the purchase of Piedmont, the payment of a cash dividend of $1.1 million and the repayment of $9.7 million of long-term loans. In the year ended December 31, 2004, net cash used in financing activities of $1.2 million was primarily attributable to our payment of $7.1 million dividend, which was offset in part by our receipt of $5.7 million in proceeds from the issuance of shares and $1.2 million from the exercise of options.

**Recent Accounting Pronouncements**

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), Share-Based Payment, which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. Statement 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The new standard was effective for the Company in the first interim period beginning after January 1, 2006. The Company implemented FAS 123(R) using the modified prospective method starting January 1, 2006. Under this method, the Company began recognizing compensation cost for equity-based compensation for all new and existing unvested share-based awards after the date of adoption. The adoption of the SFAS No. 123(R) did not have an impact on the consolidated results of operations, or to the overall consolidated financial position or consolidated cash flows. See Note 12 for further disclosure on the Company s share based plans.

In November 2004, the FASB issued Statement of Financial Accounting Standard No. 151, Inventory Costs, an Amendment of ARB No. 43, Chapter 4 ( SFAS 151 ). SFAS 151 amends Accounting Research Bulletin ( ARB ) No. 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight handling costs and wasted materials (spoilage) should be recognized as current-period charges. In addition, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. SAFS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company adopted SFAS 151 on January 1, 2006, as required. The adoption of SFAS 151 did not have a material impact on the Company s financial position or results of operations.

In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 155, Accounting for Certain Hybrid Financial Instruments-an Amendment of FASB Statements No. 133 and 140, or SFAS 155, to simplify and make more consistent the accounting for certain financial instruments. SFAS No. 155 amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, to permit fair value remeasurement for any hybrid financial instrument with an embedded derivative that otherwise would require bifurcation, provided that the whole instrument is accounted for on a fair value basis. SFAS No. 155 amends SFAS No. 140, Accounting for the Impairment or Disposal of Long-Lived Assets, to allow for a qualifying special-purpose entity to hold a derivative financial instrument that relates to a beneficial interest other than another derivative financial instrument. SFAS No. 155 applies to all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006, with earlier application permitted. Accordingly, we adopted SFAS No. 155 on January 1, 2007. The adoption of SFAS 155 is not expected to have any effect on our financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, or SFAS No. 157. Among other requirements, SFAS No. 157 defines fair value and establishes a framework for measuring fair value and also expands disclosure about the use of fair value to measure assets and liabilities. SFAS No. 157 is effective beginning the first fiscal year that begins after November 15, 2006. We are currently evaluating the impact of SFAS No. 157 on our financial position and results of operations.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No.87, 88, 106, and 132(R). SFAS No. 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position, to recognize changes in that funded status in the year in which the changes occur through comprehensive income as well as prescribing additional disclosure requirements. The provisions of this statement are effective for all other companies in fiscal years ending after June 15, 2007. In addition, a company must now measure the fair value of its plan assets and benefit obligations as of the date of its year-end balance sheet. A company is no longer permitted to measure the funded status of its plan by being able to choose a measurement date up to three months prior to year end. This provision within the Standards is effective for all companies in fiscal years ending after December 15, 2008. The Company does not anticipate the adoption of this new accounting principle will have a material effect on its financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). This Statement provides companies with an option to report selected financial assets and liabilities at fair value. Generally accepted accounting principles have required different measurement attributes for different assets and liabilities that can create artificial volatility in earnings. The Statement s objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This Statement is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 159.

In September 2006, the Securities and Exchange Commission released Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, or SAB 108, which addresses how uncorrected errors in previous years should be considered when quantifying errors in current-year financial statements. SAB 108 requires registrants to consider the effect of all carry over and reversing effects of prior-year misstatements when quantifying errors in current-year financial statements. SAB 108 does not change the Staff s previous guidance on evaluating the materiality of errors. It allows registrants to record the effects of adopting SAB 108 guidance as a cumulative-effect adjustment to retained earnings. This adjustment must be reported in the annual financial statements for the first fiscal year ending after November 15, 2006. The initial adoption of SAB 108 did not have a material impact on our financial condition and results of operation.

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes , an interpretation of SFAS 109, Accounting for Income Taxes . FIN 48 clarifies the accounting for uncertain tax positions. FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions shall initially be recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority, assuming full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements to include an annual tabular rollforward of unrecognized tax benefits. The provisions of this interpretation are required to be adopted for fiscal periods beginning after December 15, 2006. The Company will be required to apply the provisions of FIN 48 to all tax positions upon initial adoption with any cumulative effect adjustment to be recognized as an adjustment to retained earnings. As a result of the first time adoption of FIN 48 in the first quarter of 2007, the Company would recognize additional tax benefit of approximately $500,000 in its interim results for the first quarter of 2007, base on the more likely than not compromise settlement to be achieved with the Israeli Tax authorities, for tax returns of 2003 - 2005.

In March 2007, the Financial Accounting Standards Board ( FASB ) ratified Emerging Issues Task Force ( EITF ) Issue No. 06-10, Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements ( EITF No. 06-10 ). EITF No. 06-10 requires an employer to recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either Statement of Financial Accounting Standards ( SFAS ) No. 106 or Accounting Principles Board ( APB ) Opinion No. 12 if the employer has agreed to maintain a life insurance policy during the employee s retirement or provide the employee with a death benefit. EITF No. 06-10 also requires an employer to recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. EITF No. 06-10 is effective for fiscal years beginning after December 15, 2007 with early adoption permitted. The Company is evaluating the impact that the adoption of EITF No. 06-10 will have on its financial statements.

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

Not applicable

**D. Trend Information**

There are no significant recent trends that are material to production, sales and inventory, the state of the order book and costs and selling prices since the latest fiscal year.

**E. Off-Balance Sheet Arrangements**

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

**F. Tabular Disclosure of Contractual Obligations**

The following table summarizes our minimum contractual obligations and commercial commitments as of December 31, 2006 and the effect we expect them to have on our liquidity and cash flow in future periods.

| **Contractual Obligations** | **Payments due by Period** | | | | |
|---|---|---|---|---|---|
| | **Total** | **Less than 1 year** | **1-3 Years** | **3-5 Years** | **More than 5 years** |
| Long-term debt obligations | $ 8,000,000 | $ 4,000,000 | $ 2,500,000 | $ 1,500,000 | $ |
| Operating lease obligations | 2,333,500 | 493,300 | 1,054,900 | 785,300 | |
| Deferred tax liability | 436,000 | | | | 436,000 |
| Purchase obligations | | | | | |
| Estimated long-term loan interest | 635,000 | 336,000 | 266,000 | 33,000 | |
| Total | $ 11,404,500 | $ 4,829,300 | $ 3,820,900 | $ 2,318,300 | $ 436,000 |

(1) Estimates for variable rate loans are based on the rate in effect at May 31, 2007.

Pursuant to the terms of the agreement we entered into with TAT Industries in 2000 to purchase its operations relating to the manufacture of aviation accessories, we entered into a lease agreement, pursuant to which we leased from TAT Industries, effective as of January 1, 2000, the real estate and buildings encompassing an area of approximately 312,000 square feet for a period of 24 years and eleven months. In consideration for the lease agreement, we agreed to pay TAT Industries annual rental payments of approximately $316,200, with an additional incremental payment of 2% per year. Such rental rates are subject to revaluation every fifth year.

In addition, we have long-term liabilities for severance pay that is calculated pursuant to Israeli severance pay law generally based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month s salary for each year of employment or a portion thereof. As of December 31, 2006, our severance pay liability was $3,676,282.

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

**Item 6. Directors, Senior Management and Employees**

**A. Directors and Senior Management**

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

| **NAME** | **AGE** | **POSITION WITH THE COMPANY** |
|---|---|---|
| Shlomo Ostersetzer | 79 | Chief Executive Officer and Chairman of the Board of Directors |
| Dov Zeelim | 67 | President and Vice Chairman of the Board of Directors |
| Israel Ofen | 58 | Executive Vice President and Chief Financial Officer |
| Shraga Katz | 63 | Vice President Operations |
| Avi Kahana | 63 | Secretary and Manager of Import and Export Division |
| Jacob Danan | 66 | Chief Engineer and Vice President of Marketing |
| Shaul Menachem | 60 | President and Chief Executive Officer Limco- Piedmont Inc. |
| Eran Frenkel (1) | 40 | Vice-President Marketing Development |
| Yossi Rosenberg (2) | 41 | Vice-President Economics |
| Dr. Meir Dvir | 76 | Director |
| Yaacov Fish | 60 | Director |
| Ishay Davidi | 45 | Director |

| | | |
|---|---|---|
| Gillon Beck | 45 | Director |
| Yechiel Gutman | 61 | Director |
| Michael Shevi | 71 | Outside Director |
| Rami Daniel | 41 | Outside Director |

(1) Mr. Frenkel is the son-in-law of Dov Zeelim.

(2) Mr. Rosenberg is the son-in-law of Shlomo Ostersetzer. He is on a leave of absence May 2006 through October 30, 2007.

Each of our directors (except our outside directors) is elected to serve until the next annual general meeting of shareholders and until his successor has been elected. Officers serve at the discretion of the Board of Directors.

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