

NEXUS TELOCATION SYSTEMS LTD
Form 20-F
June 30, 2005

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

For the fiscal year
ended December 31, 2004

Commission File
File No.

NEXUS TELOCATION SYSTEMS LIMITED

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

Israel

(Jurisdiction of incorporation or organization)

**1 Korazin Street,
Givatayim 53583 Israel**

(Address of principal executive offices)

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

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

Ordinary Shares, NIS 0.03 nominal value per share
(Title of Class)

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:

170,450,516

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 No

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

Item 17 Item 18

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

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PART I.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIME TABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

The selected financial data is incorporated by reference to Item 5. of this annual report and should be read in conjunction with our consolidated financial statements and the notes thereto, which are set forth in Item 18 Financial Statements and are incorporated by reference, and the other financial information appearing in Item 5 of this annual report.

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

Our business, operating results and financial condition could be seriously harmed due to any of the following risks, among others. If we do not successfully address the risks to which we are subject, we could experience a material adverse effect on our business, results of operations and financial condition and our share price may decline. We cannot assure you that we will successfully address any of these risks

General Risks Factors Relating to Our Company

This annual report and statements that we may make from time to time may contain forward-looking information. There can be no assurance that actual results will not differ materially from our expectations, statements or projections. Factors that could cause actual results to differ from our expectations, statements or projections include the risks and uncertainties relating to our business described below.

Our strategic decision to focus on being a service provider, providing a range of services to automobile owners and the insurance industry could result in operating difficulties and other adverse consequences.

Between June 2004 and February 2005, we made two acquisitions in Israel becoming a leading service provider to automobile owners and insurance companies in Israel, through our currently wholly owned subsidiary Shagrir Motor Vehicle Systems Ltd. (formerly known as Pointer (Eden Telecom Group) Ltd.), or Shagrir:

In June 2004 we purchased all of the outstanding and issued shares of Pointer (Eden Telecom Group) Ltd. (renamed in January 2005, Shagrir Motor Vehicle Systems Ltd.) not already held by us. Shagrir was our local Israeli operator which provided a broad scope of services, based on our technology and know-how relating mainly to location based services, stolen vehicle retrieval and security markets.

In February 2005, pursuant to an Asset Purchase Agreement, our subsidiary, Shagrir, purchased certain of the activities and assets of Shagrir Towing Services Ltd. and its subsidiary, Shagrir (1985) Ltd. (together, Shagrir Towing Services). The business activities acquired by Shagrir constitute all of the road-side assistance and towing services of Shagrir Towing Services, which are sold to insurance companies and are provided to approximately 700,000 subscribers throughout Israel and include a fleet of approximately 120 service cars, mobile garages and towing vehicles. The assets and activities of Shagrir Towing Services have been integrated into our wholly-owned subsidiary Shagrir.

Currently Shagrir's business is expected to materially influence our business and is expected to account for the majority of our business and revenues in the foreseeable future.

In June 2004, we also incorporated a Mexican company, Pointer recuperacion de Mexico S.A. de C.V., or Pointer SA, to serve as our local Mexican operator and service provider, which would provide stolen vehicle retrieval and road-side assistance services, targeting Mexican corporations. Pointer SA became operational in February 2005 and is still in its development stage.

The process of integrating Shagrir and Pointer SA into our business is risky and may create unforeseen operating difficulties and expenses resulting from management time and efforts required to ensure successful integration. As we have limited experience in managing such processes, the anticipated benefits of these acquisitions and the incorporation of Pointer SA may not be realized. Failure to integrate the operations of Shagrir and Pointer SA into our business may have a material adverse affect on our financial condition.

We have a history of net losses.

With the exception of 2003, we have incurred a net loss in each year of our existence. While in 2003, we had net income of \$5.3 million, this resulted from a one-time non-cash capital gain of \$8.5 million from the disposal of discontinued operations, offset by a \$3.3 million loss from continuing operations. In December 2004, our accumulated deficit was approximately \$87.7 million. As a result of our acquisition in June 2004 of Shagrir, we have consolidated into our financial reports the results of a company which, prior to 2004, had never recorded net profits and which had at the time of the acquisition and continues to have a working capital deficiency. Although the business activities of Shagrir Towing Services acquired by Shagrir are profitable and are currently being integrated into Shagrir, we expect to continue to sustain net losses in the foreseen future following the acquisition mainly as a result of the amortization of intangible assets acquired in connection with the acquisition of Shagrir and the acquisition of the activities and assets of Shagrir Towing Services, as well as the increased financial burden associated with such acquisitions, including the increase in working capital deficiency (see Item 4 Recent Developments). If we continue to sustain prolonged net losses or losses from continuing operations, we may have to cease our operations.

Our future operations depend on our ability to obtain additional financing.

We have historically financed our operations through public and private placements of equity and debt securities, cash generated from the sales of our systems, grants for research and development projects and bank credit lines. Pursuant to a series of investments from March through October 2003, we issued a number of our ordinary shares and warrants with an aggregate value equal to approximately 32.5% of our current issued and outstanding capital, on a fully diluted basis. In June 2004, we purchased all of the securities of Shagrir not already held by the Company, in consideration for the issuance of a number of ordinary shares and warrants with an aggregate value equal to approximately 16.61% of our current issued and outstanding share capital, on a fully diluted basis. In February 2005, we raised \$6 million additional capital among others in order to partly finance our acquisition of the road-side assistance and towing services of Shagrir Towing Services, and accordingly issued 71,428,570 of our ordinary shares and warrants to purchase up to 15,714,284 of our ordinary shares to various investors constituting 19.23% of our current issued and outstanding share capital (assuming the exercise of all of the warrants). Also in February 2005, our subsidiary Shagrir was loaned approximately NIS 100 million in convertible debt as part of Shagrir's acquisition of the road-side assistance and towing services of Shagrir Towing Services. Pursuant to these transactions we agreed to register for resale our ordinary shares issued to our investors, our ordinary shares issuable to our investors pursuant to the exercise of warrants and our ordinary shares issuable to lenders pursuant to the conversion of the convertible debt. As a result, we currently have outstanding or intend to have outstanding in the near future, effective registration statements covering 308,264,786 our securities (excluding 15,000,000 of our ordinary shares underlying registered options) (for further information regarding agreements relating to the acquisition of the road-side assistance and towing services of Shagrir Towing Services, see Item 4 **Recent Developments** and Item 10 **Material Contracts**). We believe that our current assets, together with anticipated cash generated from operations and outstanding bank credit lines, will sufficiently allow us to continue our operations as a going concern for the foreseeable future. We cannot assure you that if we are required to raise additional financing in the future that we will be able to obtain such financing on satisfactory terms, if at all. As a result of the registration statements that we currently have outstanding and currently anticipate filing, many or all of our investors who recently purchased our securities may elect to sell some or all of our securities. Should such sales be significant in volume or take place over a short period of time, our share price may decline significantly, and we may find it difficult to raise additional funding through the issuance of equity or convertible debt securities. Additionally, should any of Shagrir's lenders convert their debt into ordinary shares of Shagrir, this may substantially dilute our interest in Shagrir thereby reducing or eliminating our ability to control its operations. If our future capital requirements are greater than the cash we obtain from our business and available financing, if any, we may, among other things, be required to significantly reduce our research, development, product commercialization, marketing or other activities or even cease operations.

Due to the downturn in the world economy over recent years, the securities markets in general have recently experienced increased volatility, which has particularly affected the securities and operations of many companies, including companies that have a significant presence in Israel. Although the volatility of these companies' securities has often been unrelated to the operating performance of these companies, they may experience difficulties in raising additional financing required to effectively operate and grow their businesses. Such failure and the volatility of the securities markets in general may affect our ability to obtain additional financing at favorable terms.

Shagrir has significant loans which it is required to repay in accordance with a strict schedule

In order to finance Shagrir's acquisition of the road-side assistance and towing services of Shagrir Towing Services, it received a NIS 100 million credit facility from Bank Hapoalim, a NIS 40 million loan from Shagrir Towing Services and approximately NIS 50 million was loaned to it from a group of investors led by Gandy Investments Ltd. and Egged Holdings Ltd. Should Shagrir fail to repay the loans in accordance with the repayment schedule pertaining to each loan and should a lender refuse to amend the relevant repayments schedule, such lender may realize certain liens that were created in its favor by Shagrir. This could result in Shagrir having to divest itself of parts of its business and may result in the cessation of its operations. This may have a material adverse affect on our financial condition. For further information on these loans, see Item 10 **Material Contracts**.

We depend on a small number of customers.

We depend on a small number of customers and our future depends on our ability to maintain our existing customers and attract new customers. For the twelve months ended December 31, 2004, four of our customers accounted for approximately 31% of our revenues. (See further Notes 1(g) and 15(b)(3) of our consolidated financial statements). As a result of our acquisition of the activities of Shagrir Towing Services, we anticipate that the customers which will account for the majority of our revenues in future years will be Israeli insurance companies, which offer our road-side assistance and towing services as part of their vehicle insurance policy packages which they sell to their customers. Should Israeli insurance companies which currently purchase these services, or any other of our major customers reduce or cancel their purchases, our financial condition may be materially adversely affected.

We depend on others to manufacture our systems and we rely on a single-source supplier for the manufacture of our end units.

We do not have manufacturing facilities for our location based system, or LBS end unit devices. Most of the components of our systems are manufactured for us by independent manufacturers abroad and are assembled by a turn-key subcontractor located in Israel, and there is no certainty that this subcontractor will be able to continue to provide us with manufacturing and assembly services in the future. Our reliance on independent contractors, especially those located in foreign countries, involves a number of risks, including:

reduced control over delivery schedules, quality assurance, manufacturing yields and cost;

reduced manufacturing flexibility due to last moment quantity changes;

transportation delays;

political and economic disruptions;

the imposition of tariffs and export controls on such products;

work stoppages;

changes in government policies; and

the loss of molds and tooling in the event of a dispute with a manufacturer.

Our agreements with our suppliers are generally short-term in nature and may be terminated with little or no notice. If a supplier of ours were to terminate its relationship with us, we may be compelled to seek additional sources to manufacture certain of the components of our systems or even to change the design of our products. Although we believe that most of the components of our systems may be readily acquired from numerous suppliers, we cannot assure you that we would be successful in entering into arrangements with other suitable independent manufacturers without significantly impairing our sales in the interim period.

We rely on operators of existing paging networks to provide our Location Based Solution systems.

One of the benefits of our automatic vehicle location (AVL) and Industrial and Monitoring Control (IMU) systems is that they utilize existing one-way paging networks, as their down-link interface, and therefore do not require a relatively large initial investment in infrastructure. In order for us to take advantage of this benefit, domestic operators of our system will need to enter into and maintain strategic relationships with wireless communications companies that control existing paging infrastructure or already provide one-way paging services to large numbers of customers. Should they fail to maintain such relationships with wireless communication companies, our business would be adversely affected.

We may not be able to successfully compete in the extremely competitive markets for our products and services.

We face intense competition in the markets in which we operate.

In Israel, our primary competitors are Europe Assistance Israel, Shlomo-SIXT and MEMSI, all of which mainly compete with us in providing road-side assistance and towing services although we currently are the leading road-side assistance and towing service provider in Israel. Ituran is our main direct competitor in the stolen vehicle retrieval services market.

Our primary competitors in the other geographical markets in which we currently operate are mainly Lo-Jack globally and Ituran in Argentina. Some offer a similar solution to ours in these markets and others, like Lo-Jack, use a VHF based messaging unit, without a wide area network, which is sold to customers and is connected via radio to local law enforcement communication networks.

In addition, in these markets and also some other potential markets, some primary location based service providers who directly or indirectly compete with us employ other technologies, such as a combination of GPS (satellite-based location technology) over cellular-like systems. These systems use commonly existing infrastructure, which offer location based services, which conform with the recent FCC ruling, requiring mobile phones to be equipped with either relatively accurate 911 capabilities (using GPS or differential time of arrival technologies), or less accurate 911 capabilities (using cell-id. technology).

Should any of our competitors in Israel or globally successfully provide a broader, more efficient or attractive combination of services to insurance companies and automobile owners, our business results could be materially adversely affected.

Most of our competitors have substantially greater capital resources and significant research and development staffs, facilities, marketing and distribution networks, name recognition and extensive customer bases. While we plan to continue to improve our services and maintain our marketing efforts, we cannot guarantee that we will grow or even maintain our customer base or we may need to invest more in our efforts to do so.

We are subject to several risks as a result of our international sales

Systems based on our products and systems are currently installed in, Israel, Argentina, Venezuela, Mexico, Russia, Chile and China. We are subject to the risks inherent in international business activities, including changes in the political and economic environment, unexpected changes in regulatory requirements, foreign exchange controls, tariffs and other trade barriers and burdens of complying with a wide variety of foreign laws and regulations. In addition, if for any reason exchange, price controls or other restrictions on conversion of foreign currencies were to be imposed, the above business could be negatively impacted. Moreover, certain of these international operations have experienced the following difficulties:

A severe and rapid currency devaluation in Argentina adversely affected Tracsat's US dollar results during 2002. This was mainly due to Tracsat's inability to increase its Argentinian Peso-denominated prices to its customers, while its major costs of inventory and infrastructure are denominated in US dollars.

Due to the current political instability in Venezuela, the Venezuelan government has imposed foreign exchange controls, which have effectively led to the cessation of purchase orders of our SVR products and services from our main customer in Venezuela during 2003.

The technology and standards in the industry in which we operate change rapidly and the introduction of products using new technology and the emergence of new industry standards and practices could negatively impact our business.

The wireless communications industry is characterized by rapid technological changes. The introduction of products using new technology and the emergence of new industry standards and practices could make our products less competitive and cause us to reduce the prices of our products. There are several wireless communications technologies, including cellular telephone, personal communications services, specialized mobile radio and mobile satellite services which have been or may be implemented in the future for applications competitive with the applications we provide. Future implementation and technological improvements could lead to the production of systems which are competitive with, or superior to ours.

We cannot assure you that we will timely or successfully develop new or enhanced products, which will effectively compete with such potential new products. Our business will be negatively impacted if we do not develop technologically competitive products that respond to customer needs and are priced competitively.

Our products employ proprietary technology, which is difficult to protect and which may infringe on the intellectual property rights of third parties.

Our success and our ability to compete in the LBS sector greatly depend on our proprietary technology. We rely on a combination of patent and trade secret laws, together with non-disclosure agreements and licensing arrangements to establish and protect proprietary rights in our products. We were granted certain patents in the United States and elsewhere; however, we have not invested significant resources to constantly update and maintain our proprietary technology. We cannot assure you that these efforts will successfully protect our technology because:

the laws of some foreign countries may not protect our proprietary rights as fully as do the laws of the United States;

if a competitor were to infringe on our proprietary rights, enforcing our rights may be time consuming and costly, diverting management's attention and our resources;

measures like entering into non-disclosure agreements afford only limited protection;

unauthorized parties may attempt to copy aspects of our products and develop similar products or to obtain and use information that we regard as proprietary; and

our competitors may independently develop or patent technologies that are substantially equivalent or superior to our technology, duplicate our technologies or design around our intellectual property rights.

In addition, others may assert infringement claims against us. The cost of responding to infringement claims could be significant, regardless of whether the claims are valid.

The use of our systems is subject to international regulations.

The use of our LBS systems is subject to regulatory approvals of government agencies in each of the countries in which our systems are operated, including the State of Israel. We thus obtained in 2001 a regulatory acceptance from the FCC for our vehicular end-unit device (RMU) and for our SVR receiving base station. Our operators typically must obtain authorization from each country in which these systems are installed. While, in general, applicants have not experienced problems in obtaining regulatory approvals to date, the regulatory schemes in each country are different and may change from time to time. We cannot guarantee that approvals, which our operators have obtained, are or will remain sufficient in the view of regulatory authorities. In addition, we cannot assure you that operators of our systems will obtain licenses and approvals on a timely basis in all jurisdictions in which we wish to sell our systems or that restrictions on the use of our systems will not be unduly burdensome.

Our potential growth in the geographical territories where we do not control the domestic operator depends, to a great extent, on the success of the domestic operators of our system in commercializing our technology and marketing their services.

The commercialization of our LBS systems and other services in each territory in which we operate is performed and controlled by the operators in each of these territories who license our technology, purchase our infrastructure and end units, and market their services in their territories. With the exception of Tracsat, our Argentinean subsidiary, Pointer SA our Mexican subsidiary, and Shagrir our Israeli subsidiary we do not control any of the other operators. The implementation of the operators' business plans depends mainly on their marketing strategies, their future financial stability and the specific requirements and circumstances in their territories. Our consecutive end unit sales, future system upgrades, future infrastructure extensions and revenues from royalties, where applicable, from such territories will be dependent on their penetration rate and successful sale growth as well as on the operators' continuous success and their continuous decision to offer these services and products in their respective territories. To date, such operations that we do not control are essentially limited to Venezuela, Russia, China and Chile, while we do control such operations in Israel, Mexico and Argentina. If we were to experience any setbacks regarding such operators, this would have a material adverse effect on our business.

We may not be able to retain or attract key managerial, technical and research and development personnel that we need to succeed.

Our success has largely depended and will depend in the future on our skilled professional and technical employees, substantially all of whom have written employment agreements. The competition for these employees is intense. We may not be able to retain our present employees, or recruit additional qualified employees, as we require them.

High levels of inventory could adversely affect our gross margins.

Should we fail to meet sales forecasts or suffer cancellations of orders from customers, we may find ourselves with a higher level of inventory than we currently need. For the twelve months ended December 31, 2004, we incurred inventory write-offs of \$0.479 million. As a result of a high level of inventory, we may be exposed to the risk of a decrease in the value of the inventory should the price of this inventory drop, causing our gross margins to be adversely affected. Furthermore, in the event that we maintain large amounts of inventory, certain products might be rendered obsolete due to modification and improvement of our products, which might cause us to continue to incur inventory write-offs.

Our major shareholders have a controlling stake in our company.

Pursuant to the share purchase agreement of March 2003 wherein DBSI Investments Ltd., or DBSI and other investors invested approximately \$2.6 million in our company, the investments completed in second half of 2003, wherein DBSI and other investors invested approximately \$1.2 million, and the share purchase agreement consummated in February 2005, in which DBSI invested a further \$1 million, DBSI currently owns approximately 25.38% (on a fully diluted basis), of our issued and outstanding shares. Pursuant to the Shareholders Agreement between DBSI and Egged Holdings Ltd., or Egged, DBSI also has the right to appoint four out of our seven directors on our Board of Directors, and thus effectively controls our Board of Directors. In addition, under the Shareholders Agreement with Egged, DBSI will vote its shares in favor of one director nominated by Egged. According to the terms of the Shareholders Agreement, Egged and DBSI will also vote their shares against certain resolutions brought to our shareholders for a resolution, such as new share issuances, increases in our share capital and certain transactions, unless they agree to vote otherwise. As a result, DBSI and Egged have the ability to control material decisions requiring the approval of our shareholders. For further information on the Shareholders Agreement between DBSI and Egged, see Item 10 **Material Contracts**.

Risk Factors Relating to our Ordinary Shares

We do not expect to distribute cash dividends.

We do not anticipate paying cash dividends in the foreseeable future. Our Board of Directors will decide whether to declare any cash dividends in the future based on the conditions then existing, including our earnings and financial condition. According to the Israeli Companies Law, a company may distribute dividends out of its profits, so long as the company reasonably believes that such dividend distribution will not prevent the company from paying all its current and future debts. Profits, for purposes of the Companies Law, means the greater of retained earnings or earnings accumulated during the preceding two years.

The market price of our ordinary shares has been, and may continue to be, very volatile.

The market prices of our ordinary shares have fluctuated widely. The following factors, among others, may significantly impact the market price of our ordinary shares:

- macro changes and changes in market share in the markets in which we provide services and products;
- announcements of technological innovations or new products by us or our competitors;
- developments or disputes concerning patents or proprietary rights;
- publicity regarding actual or potential results relating to services rendered by us or our competitors;
- regulatory development in the United States, Israel and other countries;
- events or announcements relating to our collaborative relationship with others;
- economic, political and other external factors;

period-to-period fluctuations in our operating results; and

substantial sales by significant shareholders of our ordinary shares which are currently or are in the process of being registered.

In addition, the securities markets in general have experienced volatility, which has particularly affected the market prices of equity securities of many companies and companies that have a significant presence in Israel. This volatility has often been unrelated to the operating performance of such companies.

Our shares have been delisted from the Nasdaq SmallCap Market.

In August 2002, our shares were delisted from the Nasdaq SmallCap Market and are now traded on the OTC Bulletin Board as a result of our failure to comply with the net tangible assets or stock holders equity requirements for continued listing set forth in NASDAQ Marketplace Rule 4310(c)(2)(B). Consequently, selling and buying our securities has become more difficult because of delays in the timing of transactions and in obtaining accurate quotations. Furthermore, broker-dealers are subject to an SEC rule that imposes additional sales practice requirements on broker-dealers who sell low-priced securities to persons other than established customers and institutional accredited investors. For transactions covered by this rule, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written agreement to the transaction prior to sale. These factors may affect the ability of broker-dealers to sell our ordinary shares and of shareholders to sell our ordinary shares in the secondary market and in turn could result in lower prices and larger spreads in the bid and ask prices for our ordinary shares than might otherwise be obtained.

Our ordinary shares may be affected by limited trading volume and may fluctuate significantly in price.

Our ordinary shares are traded on the Over-the-Counter Bulletin Board. Trading in our ordinary shares has been limited and there can be no assurance that an active trading market for our ordinary shares will develop. As a result, this could adversely affect our shareholders' ability to sell our ordinary shares in short time periods, or possibly at all. Thinly traded ordinary shares can be more volatile than ordinary shares traded in an active public market. The average daily trading volume of our ordinary shares in May 2005 was 147,233 shares. The high and low bid price of our ordinary shares for the last two years has been \$0.58 and \$0.08, respectively. Our ordinary shares have experienced, and are likely to experience in the future, significant price and volume fluctuations, which could adversely affect the market price of our ordinary shares without regard to our operating performance.

Our Ordinary Shares are deemed to be Penny Stock which may make it more difficult for investors to sell their shares due to suitability requirements.

Our ordinary shares are deemed to be penny stock as that term is defined in Rule 3a51-1 promulgated under the Securities Exchange Act of 1934. Penny stocks are stock:

With a price of less than \$5.00 per share;

That are not traded on a recognized national exchange;

Whose prices are not quoted on the NASDAQ automated quotation system; or

In issuers with net tangible assets less than \$2.0 million (if the issuer has been in continuous operation for at least three years) or \$5.0 million (if in continuous operation for less than three years), or with average revenues of less than \$6.0 million for the last three years.

Broker/dealers dealing in penny stocks are required to provide potential investors with a document disclosing the risks of penny stocks. Moreover, broker/dealers are required to determine whether an investment in a penny stock is a suitable investment for a prospective investor. These requirements may reduce the potential market for our ordinary shares by reducing the number of potential investors. This may make it more difficult for our shareholders to sell shares to third parties or to otherwise dispose of them. This could cause our share price to decline.

Corporate governance scandals and new legislation could increase the cost of our operations.

As a result of recent corporate governance scandals and the legislative and litigation environment resulting from those scandals, the costs of being a public company in general have increased and may continue to increase in the near future. Legislation, such as the Sarbanes-Oxley Act of 2002, has had and may continue to have the effect of increasing the burdens and potential liabilities of being a public reporting company. This and other proposed legislation may increase the fees of our professional advisors and our insurance premiums.

We do not publicize our quarterly financial statements.

As a foreign private issuer, we are only required to publicize our annual financial statements. However, until 2002, we disclosed unaudited quarterly financial statements as a customary practice. In order to minimize general costs, we decided, in 2003, to discontinue this practice. As of January 1, 2003, we only publish our annual financial information as required by law and unaudited semi-annual financial statements. As a result, investors are no longer able to receive periodic financial information on a quarterly basis. This will affect their ability to assess the condition of our results and operations.

Risk Factors Relating to Our Operations in Israel

Conditions in Israel affect our operations.

We are incorporated under the laws of the State of Israel. Our headquarters, the headquarters of Shagrir, our operations and the operations of Shagrir, are located in Israel. We are directly affected by the political, economic and military conditions affecting Israel. Any major hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could materially adversely affect our business, financial condition and results of operations. Israel's economy has been subject to numerous destabilizing factors, including a period of rampant inflation in the early to mid-1980's, low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. Since the establishment of the State of Israel in 1948, hostility has existed, varying in degree and intensity, between Israel and the Arab countries. In addition, Israel and companies doing business with Israel have been subject to an economic boycott by the Arab countries. Although Israel has entered into agreements with some Arab countries and the Palestinian Authority, and various declarations have been signed in connection with efforts to resolve some of the economic and political problems in the Middle East, there has been a significant increase in violence since September 2000 which continued with varying levels of severity through 2004. Since the death of Yasser Arafat in 2004, low-level negotiations between Israel and Palestinian representatives have been renewed. Nevertheless, the political and security situation in Israel may result in certain parties with whom we have contracts claiming that they are not obligated to perform their commitments under those agreements pursuant to force majeure provisions. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could adversely affect our operations and could make it more difficult for us to raise capital. Furthermore, many of our employees and subcontractors are located in Israel, which could still face a renewal of civil unrest, terrorist activity and military action. Since we do not have a detailed disaster recovery plan that would allow us to quickly resume business activity, we could experience serious disruptions if acts associated with this conflict result in any serious damage to our facilities. Our business interruption insurance may not adequately compensate us for losses that may occur and any losses or damages incurred by us could have a material adverse effect on our business. We cannot give any assurance that security and political conditions will not have such an effect in the future. Any future armed conflicts or political instability in the region would likely negatively affect business conditions and harm our results of operations.

Furthermore, all non-exempt male adult permanent residents of Israel especially under the age of 40, including some of our office holders and employees, are obligated to perform military reserve duty and may be called to active duty under emergency circumstances. Recently, there has been a significant call up of military reservists, and it is possible that there will be additional call-ups in the future. While we have operated effectively despite these conditions in the past, we cannot assess the impact these conditions may have on us in the future, particularly if emergency circumstances occur. 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 our other employees due to military service. Any disruption in our operations would harm our business.

The Israeli rate of inflation may negatively impact our costs if it exceeds the rate of devaluation of the New Israeli Shekel against the U.S. dollar.

A part of our costs in Israel is not denominated in dollars and may be influenced from the rate of devaluation of the New Israeli Shekel. This exposes us to market risk from changes in foreign exchange rates as against the U.S. dollar, as our dollar costs in Israel may increase if inflation in Israel exceeds the devaluation of the NIS against the dollar or if the timing of such devaluation lags behind inflation in Israel. In the twelve months ended December 31, 2004, the Israeli economy recorded inflation of approximately 1.2% and the U.S. dollar devalued against the NIS by approximately 1.65%, this is not typical. For further discussion of such devaluation, see Item 5, Impact of Exchange Rate Fluctuations on Results of Operations, Liabilities and Assets and Item 11, Quantitative and Qualitative Disclosures About Market Risk. There can be no assurance that we will not incur losses from such fluctuations in the future.

We may not be eligible to receive grants or programs provided to us from our participation in research and development, investments and other programs or we may be restricted from manufacturing products or transferring our intellectual property outside of Israel.

We have received certain grants and programs from the Israeli Government, the European Union and the BIRD Foundation. Some of these programs may restrict our right to manufacture products or transfer our intellectual property outside of Israel. If we do not meet certain conditions in the future, the benefits we receive could be canceled and we may have to refund payments previously received under these programs and pay higher royalties. We cannot guarantee that these grants and programs will be continued in the future, at their current or historical levels or at all. If these grants and programs are ended, our business, financial condition and results of operations could be adversely affected.

Service and enforcement of legal process.

Service of process upon directors and officers of our company and the Israeli experts named herein, all of who reside outside the United States, may be difficult to effect within the United States. Furthermore, since the majority of our assets are located outside the United States, any judgment obtained against us in the United States may not be enforceable within the United States. We have been informed by our legal counsel in Israel, Yigal Arnon & Co., that there is doubt as to the enforceability of civil liabilities under the Securities Act and the Exchange Act in original actions instituted in Israel. However, subject to certain time limitations, Israeli courts may enforce United States final executory judgments for liquidated amounts in civil matters obtained after due trial before a court of competent jurisdiction (according to the rules of private international law currently prevailing in Israel) which enforces similar Israeli judgments, provided that: (i) due service of process has been effected; (ii) such judgments or the enforcement thereof are not contrary to the law, public policy, security or sovereignty of the State of Israel; (iii) such judgments were not obtained by fraud and do not conflict with any other valid judgment in the same matter between the same parties; and (iv) an action between the same parties in the same matter is not pending in any Israeli court at the time the lawsuit is instituted in the foreign court.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Until 2003, our business focused primarily on the development, manufacture and sale of location based services and stolen vehicle retrieval services. In April 2003, our management decided to strategically focus on providing a range of services to automobile owners and insurance companies.

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Our new strategy was implemented through two acquisitions in Israel and the establishment of a subsidiary in Mexico.

In June 2004 we purchased all of the outstanding and issued share capital of Shagrir not already held by us. Shagrir was our local Israeli operator and service provider, which mainly provided stolen vehicle retrieval and other security value-added services mainly for vehicle owners through a communication network based on our technology.

In June 2004, we also incorporated a Mexican company, Pointer SA, to serve as our local Mexican operator and service provider, which would provide stolen vehicle retrieval and road-side assistance services for vehicle owners using a communication network based on our technology.

In February 2005, our subsidiary, Shagrir, purchased the assets and activities of Shagrir Towing Services, an Israeli company which provided road-side assistance and towing services, in Israel.

As a result of the implementation of our strategy, we currently provide a range of services to automobile owners and insurance companies.

As a result of the two acquisitions we made in Israel, Shagrir, is currently the most significant operation we have, and is expected to account for the majority of our business and revenues in the foreseeable future. In Israel we currently provide all the range of our services.

Nexus was founded in 1991 by BVR Technologies Ltd. At that time, we began developing specialized long-range wireless solutions for location and messaging applications, using Frequency Hopping Spread Spectrum technology. Our legal and commercial name is Nexus Telocation Systems Ltd, and through December 1997 we operated under the name Nexus Telecommunication Systems, Ltd. We operate under the Israel Companies Law 1999. Our shares are publicly traded on the Over-The-Counter Bulletin Board under the symbol NXUSF. Our executive offices and research and development main facilities are located in 1 Korazin Street, Givatayim, 53583, Israel, telephone number 972-3-572-3111. The headquarters of our subsidiary, Shagrir, are located in Holon, Israel and Petach-Tikva, Israel. The headquarters of our subsidiary, Tracsat S.A., are located in Buenos Aires, Argentina. The headquarters of our subsidiary, Pointer SA, are located in Mexico City, Mexico. In January 2005, our subsidiary, Pointer (Eden Telecom Group) Ltd., was renamed Shagrir Motor Vehicle Systems Ltd. Our Web site is www.nexus.telocation.com. Information on our web site is not incorporated by reference in this annual report.

Recent Developments

Since January 1, 2004, the following important events have occurred to us:

Employment Agreement with our Chief Executive Officer

In May 2005, our Board of Directors approved an agreement with Mr. Danny Stern to serve as our chief executive officer. Pursuant to the agreement, Mr. Stern receives an annual gross salary of NIS 540,000 and was granted options to purchase 4,000,000 of our ordinary shares at an exercise price of \$0.106 per share, pursuant to our 2003 option plan. Such options can be exercised in full after 48 months of continuous service, with 25% of the options vesting after each 12 month-period of continuous service. In addition, at the end of his first six months period of employment, we have agreed to determine an annual bonus mechanism.

The Purchase of Certain of the Activities of Shagrir Towing Services by our subsidiary, Shagrir

On February 28, 2005 pursuant to an Asset Purchase Agreement, Shagrir, our fully-owned subsidiary completed the purchase of the road-side assistance and towing services of Shagrir Towing Services, in consideration for approximately NIS 200 million. NIS 100 million was funded by a loan from Bank Hapoalim B.M, NIS 40 million was funded by a loan provided by Shagrir Towing Services and approximately NIS 50 million was loaned by a group of our shareholders led by Gandyr Investments Ltd. and Egged Holdings Ltd. In addition we invested an amount of NIS 4,550,000 in the share capital of Shagrir and provided it with a loan of NIS 5,000,000. As part of the transaction, we granted Bank Hapoalim B.M a two year warrant to purchase up to 10,000,000 of our ordinary shares, at a price per share of \$0.18; and granted Shagrir Towing Services a two year warrant to purchase up to 25,000,000 of our ordinary shares, at a price per share of \$0.18. Part of the loans provided by the investors led by Gandyr Investments Ltd. and Egged Holdings Ltd. may be converted into our shares and/or the shares of our subsidiary, Shagrir. For further information relating to the purchase of the activities and assets of Shagrir Towing Services, see Item 10 **Material Contracts**.

\$6 million Investment

On February 28, 2005, a group of investors, including our controlling shareholder DBSI Investments Ltd, or DBSI, completed a \$6 million investment in our share capital. Pursuant to the investment agreements, we issued (i) 71,428,570 of our ordinary shares at a price per share of \$0.084 (of which 30,952,381 were issued to Egged Holdings Ltd., or Egged) and (ii) warrants to purchase up to 15,714,284 of our ordinary shares at the same exercise price (of which warrants to purchase up to 6,809,523 of our ordinary shares were issued to Egged), constituting approximately 19.23% of our current issued and outstanding share capital on a fully-diluted basis. Under the terms of the agreements, the warrants are exercisable until the earlier of: (a) April 6, 2006; or (b) our merger or the acquisition of substantially all of our assets. The transaction was approved by our shareholders at their annual meeting held on February 1, 2005. In addition, on March 13, 2005, we entered into a joinder agreement with the general manager of Shagrir, Mr. Ofer Lior pursuant to which in consideration for \$69,735 we issued Mr. Lior (i) 830,179 of our ordinary shares at a price per share of \$0.084 and (ii) a warrant to purchase up to 182,639 of our ordinary shares at the same exercise price, constituting approximately 0.22% of our current issued and outstanding share capital on a fully-diluted basis. This warrant is exercisable by Mr. Lior until the earlier of: (a) April 6, 2006; or (b) our merger or the acquisition of substantially all of our assets.

As part of the investment, DBSI and the major new investor, Egged consummated a shareholders agreement, pursuant to which they agreed to vote their shares jointly in respect of certain matters relating to our company and Shagrir. For further information on the Shareholders Agreement, see Item 10 **Material Contracts**.

Cooperation and Share Exchange Agreements with Shagrir

On February 25, 2004, we entered into a cooperation agreement with Shagrir, the operator of our system in Israel. As part of this agreement Shagrir renewed its commitment to purchase exclusively from us end units for its stolen vehicle retrieval system. Shagrir undertook to purchase in 2004 end-units in an amount of \$2.3 million and during the following three years, in a minimum amount of \$4.2 million. We undertook to expand Shagrir's infrastructure network. The term of the agreement is until the end of year 2007.

Subsequently, on April 25, 2004, we entered into an agreement with the shareholders of Shagrir, whereby we increased our holdings in Shagrir from 14% to 100% of its issued share capital. Upon completion of the agreement on June 29, 2004, we purchased all the outstanding shares and options to purchase shares of Shagrir. Upon completion of the transaction, we purchased from certain of Shagrir's shareholders their rights to repayment by Shagrir of an aggregate of \$5,215,043.50 pursuant to loans which they provided to Shagrir. In consideration for the right to receive repayment of the loans, we issued such shareholders 10,430,086 of our ordinary shares, constituting one of our ordinary shares for every \$0.50 owed to such shareholders pursuant to the loans. Furthermore, upon completion of the transaction, we provided certain shareholders of Shagrir which provided bank guarantees to Shagrir for an aggregate amount of \$1,644,444.50, with an indemnification letter pursuant to which we agreed to indemnify them in the event of the banks exercising their guarantees. In consideration for the indemnification letters provided by us to such shareholders, the number of our ordinary shares that we issued to them pursuant to the aforementioned acquisition transactions was reduced by an aggregate of 2,288,888 ordinary shares, constituting one of our ordinary shares for each \$0.50 that we have agreed to indemnify them pursuant to the guarantees. In addition, pursuant to the agreement, a number of options in Shagrir held by its employees were converted into 7,589,620 options of our company, constituting, an aggregate of 1.67% of our current issued share capital on a fully diluted basis. In consideration for all of the above, we transferred a number of our ordinary shares, warrants and employees options with an aggregate value equal to approximately 16.61% of our current issued share capital on a fully diluted basis, including the employees options as mentioned above and warrants to purchase up to 24,778,091 of our ordinary shares at an exercise price of \$0.044, exercisable until the earlier of: (a) April 6, 2006; or (b) our merger or the acquisition of substantially all of our assets. Prior to the completion of the acquisition, the directors of Shagrir resigned from its board of directors and we assumed full control of Shagrir.

Exercise of warrants by Bank Hapoalim and other minority investors

From January 1, 2004 through June 20, 2005, 17,501,364 warrants were exercised into our ordinary shares, par value NIS 0.03 each. Of these, warrants to purchase 11,051,818 of our ordinary shares were exercised by a cashless exercise into 9,737,409 ordinary shares (of which Bank Hapoalim exercised warrants to purchase 5,113,636 ordinary shares into 4,622,012 ordinary shares), and another 6,449,546 warrants were exercised into ordinary shares, for approximately \$284,000.

Incorporation of Local Mexican Operator

On June 17, 2004 we incorporated a local Mexican operator and service provider, Pointer SA, jointly held by us and our Mexican local partners, 96.5% and 3.5% respectively. On January 25, 2005 we sold to our local partners 28.5% of our holdings in Pointer SA in consideration for its par value and thus we currently hold 68%. Pointer SA offers a broad scope of services, based on our technology and know-how relating to location based services, stolen vehicle retrieval and other value-added services targeting Mexican corporations. Pointer SA commenced operations in February 2005 and is currently in its development phase.

Renewal of Purchase Orders in Venezuela

In January 2004, the customer in Venezuela renewed its purchase orders after not having ordered from us for approximately two years. In 2004, this customer ordered over US \$1 million worth of infrastructure equipment, spare parts and end units. However, due to continuous political and economical uncertainties in Venezuela, we cannot be sure of any further purchase orders from this customer and the timing of such.

Potential Claim

On November 26, 2002, we filed a claim with the Tel-Aviv Magistrate's Court for a permanent injunction against Bank Hapoalim B.M and the China National Electronics Import Export Beijing Company, or CEIEC. In the claim we requested that the court injunct Bank Hapoalim from paying CEIEC any sums pursuant to a guarantee in the amount of \$300,000 in favor of CEIEC provided to it in the framework of a previous transaction, and to injunct CEIEC from requesting Bank Hapoalim to pay it any sums pursuant to the guarantee. We requested the injunction as a result of unlawful requests made by CEIEC that Bank Hapoalim pay it the guarantee. Following a hearing in which CEIEC did not attend, the Tel-Aviv Magistrate's Court ruled in our favor on December 31, 2002, granting a permanent injunction prohibiting Bank Hapoalim from paying any funds to CEIEC pursuant to the guarantee and injuncting CEIEC from requesting Bank Hapoalim to pay it any funds pursuant to the guarantee. We understand that sometime in 2003 CEIEC commenced proceedings in China to which we have not been joined as a party, for payment of the guarantee plus interest at a rate of 0.5% commencing March 2002, and has since received interim judgments in the matter, the exact nature of which are not currently clear to us. In August 2004, Bank Hapoalim informed us, that it may pay CEIEC the guaranteed sum plus interest, and in such an event will request that we indemnify it for the amount paid. In light of the permanent injunction ordered in our favor in 2002, and without our knowledge of the exact nature of the legal proceedings underway between the Bank and CEIEC, since we are not a party to these proceedings, based on our legal advisors' opinion, we have a good defense against Bank Hapoalim's claim for indemnification.

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In March, 2005 we filed a claim against CEIEC and a third party with the China International Economic and Trade Arbitration Commission in Beijing, China (CIETAC) for approximately \$558,000 representing the damages caused to us by the breach of the contract between us, CEIEC and the third party pursuant to which contract, the guarantee mentioned in the paragraph above was given.

In June, 2005 CEIEC and the third party filed a counter claim with the CIETAC for repayment of \$300,000 relating to the same transaction, plus weekly interest of 0.5% (compounded from February 2002). The counter claim relates to the same amount that CEIEC has claimed from Bank Hapoalim B.M pursuant to the guarantee discussed above. Based on our legal advisors' opinion, we have a good defense against any claim of CEIEC and the third party.

Grant of Options to Employees

On June 1, 2004, our board of directors resolved to issue to our employees options to purchase approximately 2.2 million of our ordinary shares, pursuant to our 2003 Employee Share Option Plan, at an exercise price of 13.3 cents (\$0.133) per share. 44% of the options granted to each employee shall vest on December 31, 2004. An additional 7% of the options granted to each employee shall vest at the end of each of eight consecutive quarters, ending December 31, 2006. The options are subject to the terms of the 2003 Employee Share Option Plan.

Investment in Property and Equipment

During the years 2004, 2003 and 2002, we had capital expenditures of \$0.9 million, \$1.1 million and \$1.2 million, respectively, related mainly to the installment of equipment used by Tracsat, our subsidiary in Argentina and Pointer SA, our subsidiary in Mexico.

For a description of additional recent developments which have taken place since January 1, 2004, see Item 10 Information on the Company Material Contracts.

B. BUSINESS OVERVIEW

We are a service provider of a range of services to automobile owners and insurance companies, including road-side assistance, vehicle towing, stolen vehicle retrieval and other value added services. We provide our services, for the most part, in Israel, through our subsidiary, Shagrir (which recently acquired the assets and activities of Shagrir Towing Services), and in Argentina and Mexico through our subsidiaries Tracsat and Pointer SA respectively. In addition, we continue to develop and manufacture our location based information system the Nexusphere for the use of our subsidiaries and for marketing it to other third party local operators through which they provide location based and security services.

As a result of the implementation of our strategy, we currently provide the following range of services to automobile owners and insurance companies:

- (i) Road-side assistance these services may include towing services which are provided in Israel either directly by us or using sub-contractors, mobile automobile repair services, vehicle replacement services, the sale of spare-parts or connecting the driver to other service providers.
- (ii) Stolen vehicle services these include our vehicle replacement services and our vehicle retrieval services, which are based on the systems we use, develop and sell and through which, in co-operation with law enforcement and private security agencies, we prevent the cars from being stolen or retrieve them.
- (iii) Value added services may include location through the internet and other location based services provided to the drivers contacting our call center.

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We currently provide such services mainly in Israel and in addition, but to a lesser extent, in Argentina and Mexico through subsidiaries in each country: Tracsat (we currently hold approximately 86.5% of the issued share capital of Tracsat) and Pointer SA (we currently hold 68% of the issued share capital of Pointer SA), respectively.

In addition, there are currently other operators in Venezuela, Russia, China and Chile using our Nexusphere communication and location and system and technology, to which we continue to market our products, systems and technical support.

The Nexusphere Network

Our Nexusphere network is based on spread spectrum technology (SPSP) intended for wide area networks (WAN). Among the advantages of Nexusphere's utilization of the spread spectrum technology includes the following distinctive features: resistance to interference, overcoming of fading caused by multipath and highly sensitive receivers.

The architecture of our Nexusphere system allows easy integration with existing infrastructures, low-cost expansion, development of multiple applications, and access to the internet and public switched telephone network gateways, all of which provide the following advantages:

- high receiver sensitivity;
- longer transmission ranges;
- resistance to interference;