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BOS BETTER ONLINE SOLUTIONS LTD  
Form 6-K  
January 10, 2005

FORM 6 - K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Issuer

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

For the Month of January 2005

B.O.S. BETTER ON-LINE SOLUTIONS, LTD.  
(Translation of Registrant's Name into English)

100 BOS ROAD, TERADYON 20179, ISRAEL  
(Address of Principal Corporate Offices)

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

Form 20-F  Form 40-F

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

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

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

Yes  No

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

THIS FORM 6-K IS HEREBY INCORPORATED BY REFERENCE INTO THE REGISTRANT'S REGISTRATION STATEMENTS ON FORM S-8 (NOS. 333-110696, 333-100971 AND 333-11650), AND TO BE A PART THEREOF FROM THE DATE ON WHICH THIS REPORT IS SUBMITTED, TO THE EXTENT NOT SUPERSEDED BY DOCUMENTS OR REPORTS SUBSEQUENTLY FILED OR FURNISHED.

This Form 6-K consists of the following financial information:

A. INFORMATION CONCERNING B.O.S BETTER ONLINE SOLUTIONS LTD.:

(i) Management's Discussion and Analysis of Results of Operations and Financial

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Condition for the nine months ended September 30, 2004 and September 30, 2003.

(ii) Unaudited Financial Statements as of September 30, 2004.

(iii) Unaudited Proforma Condensed Combined Financial Statements (reflecting the acquisition of shares of Odem Electronic Technologies 1992 Ltd. and of the assets of Quasar Communication Systems Ltd.)

### B. INFORMATION CONCERNING SURF COMMUNICATIONS SOLUTIONS LTD.

Unaudited Interim Consolidated Financial Statements as of September 30, 2004.

### C. INFORMATION CONCERNING QUASAR COMMUNICATION SYSTEMS LTD.

Financial Statements as of December 31, 2003.

Unaudited Interim Financial Statements as of September 28, 2004.

### D. INFORMATION CONCERNING ODEM ELECTRONIC TECHNOLOGIES 1992 LTD.

Consolidated Financial Statements as of December 31, 2003.

Unaudited Interim Consolidated Financial Statements as of September 30, 2004.

Signature

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

B.O.S. Better On-Line Solutions, Ltd.  
(Registrant)

By: /s/ Adiv Baruch

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Adiv Baruch  
President and CEO

Dated: January 10, 2005

## RESULTS OF OPERATION

### COMPARISON OF NINE MONTHS ENDED SEPTEMBER 30, 2004 AND SEPTEMBER 30, 2003

Revenues for the nine months ended September 30, 2004 were \$4,043 thousands compared to \$4,202 thousands recorded for the nine months ended September 30, 2003.

Gross profit for the nine months ended September 30, 2004 was \$2,116 thousands, or 52.3% of revenues, compared to \$3,141 thousands or 74.7% of revenues for the

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nine months ended September 30, 2003 (or \$2,802 thousands and 66.7% of revenues, when excluding income of \$339 thousands in the nine months ended September 30, 2003 due to a reversal of a non-recurring royalty for the Office of the Israeli Chief Scientist). The major reason for the decrease in gross profit was an increase in revenues from new products with lower gross margins such as Thin Clients, which were introduced in 2004.

Research and development expenses for the nine months ended September 30, 2004 were \$1,559 thousands compared to \$1,686 thousands for the nine months ended September 30, 2003. This decrease was mainly due to a reduction of 16% of our research and development workforce. Income from grants and participation in research and development cost represent funding that we received from the Office of the Chief Scientist. The approved grant by the Office of the Chief Scientist for the year 2004 was \$511 thousands compared to \$283 thousands for the year 2003. As a result, the income from grants for the nine months ended September 30, 2004 was \$370 thousands compared to \$202 thousands in the nine months ended September 30, 2003.

Selling and marketing expenses for the nine months ended September 30, 2004 were \$933 thousands compared to \$1,934 thousands for the nine months ended September 30, 2003, a 51.7% decrease. The decrease in selling and marketing expenses for the nine months ended September 30, 2004 resulted from a reorganization of our sales and marketing organization. In Europe, up until the second quarter of 2003, we marketed our BOScom products through subsidiaries in the U.K. and France. Currently, we market our products through local distributors that provide pre and post-sales support. Products sold in the rest of the world are serviced from our headquarters in Israel. In addition, as a result of the reorganization, in the nine months ended September 30, 2003, we recorded a restructuring cost of \$592 thousands.

General and administrative expenses for the nine months ended September 30, 2004 increased to \$1,152 thousands compared to \$1,020 thousands for the nine months ended September 30, 2003, mainly due to the increase in management human resources.

Equity losses of an affiliated company, Surf Communications Solutions Ltd. for the nine months ended September 30, 2004 amounted to \$215 thousands compared to \$341 thousands for the nine months ended September 30, 2003.

Net loss from continuing operations for the nine months ended September 30, 2004 was reduced by 32% to \$1,424 thousands from \$2,093 thousands for the nine months ended September 30, 2003.

The net loss related to the discontinuing operations for the nine months ended September 30, 2004 was \$18 thousands compared to an income of \$2,114 thousands in the nine months ended September 30, 2003. The income in the nine months ended September 30, 2003 resulted from debt settlement with the external creditors of Pacific Information Systems Inc., for an amount that was significantly lower than the face value of the debt.

The total net loss for the nine months ended September 30, 2004 was \$1,442 thousands, compared to net income of \$21 thousands in the nine months ended September 30, 2003. On a per share basis, the net loss for the nine months ended September 30, 2004 was \$0.35 per share compared to a \$0.01 net earning per share in the nine months ended September 30, 2003.

### LIQUIDITY AND CAPITAL RESOURCES

We finance our activities by different means, including equity financings,

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long-term loans, grants from the Office of the Chief Scientist in Israel and income from operating activities.

In December 2003, we received net proceeds of \$928 thousands from a private placement with two European investors. We issued these investors 357,143 ordinary shares at a price per share of \$2.80. We also granted these investors certain incidental registration rights with respect to the ordinary shares they purchased.

On June 10, 2004, we entered into a Securities Purchase Agreement with Laurus Master Fund Ltd., under which we issued and sold to Laurus in a private placement a Secured Convertible Term Note of a \$2 million principal amount, due June 10, 2007 and a warrant to purchase 130,000 ordinary shares at an exercise price of \$4.04 per share. The Warrant is exercisable, in whole or in part, until June 10, 2011. The Note bears interest at a fluctuating interest rate equal at all times to the prime rate plus 3%, subject to reduction if the average closing price of the our ordinary shares exceeds certain benchmarks. The proceeds from the private placement are being used for general working capital purposes and/or mergers and acquisitions.

The Note is convertible into our ordinary shares at a price of \$3.08 per share (subject to adjustment). The principal amount of the Note is repayable in monthly installments, commencing as of October 1, 2004, in the initial amount of \$20,000 eventually increasing to \$73,600, and may be paid in cash or, subject to certain conditions, in ordinary shares. Interest on the Note is payable monthly and may be paid in cash or, subject to certain conditions, in ordinary shares. The Note is secured by a security interest on certain of our assets.

We also entered into a Registration Rights Agreement with Laurus pursuant to which we agreed to prepare and file with the Securities and Exchange Commission within 45 days a registration statement covering the resale of the ordinary shares that are issuable upon conversion of the Note (including interest) and/or exercise of the Warrants. A delay in the effectiveness of the registration of our ordinary shares beyond a certain date subjects us to payment to Laurus of liquidated damages equal to 2.0% of the outstanding principal amount of the note for each thirty (30) day period of delay (prorated for partial periods).

As of September 30, 2004, we had \$5,098 thousands in cash and cash equivalents, \$2,490 thousands in marketable securities, and positive working capital of \$6,299 thousands. Net cash used in operating activities of continuing operations in the nine months ended September 30, 2004 was decreased to \$688 thousands compared to \$2,535 thousands in the nine months ended September 30, 2003. The major reason for this decrease was a decrease in the net loss from continuing segments to \$1,424 thousands in the nine months ended September 30, 2004 compared to \$2,093 thousands in the nine months ended September 30, 2003. Net cash provided by financing activities in the nine months ended September 30, 2004 was \$1,785 thousands compared to net cash used in financing activities in the amount of \$159 thousands in the nine months ended September 30, 2004. The net cash provided by financing activities in the nine months ended September 30, 2004 was related to proceeds from long term convertible note in the amount of \$1,805 thousands, net of issuance expenses.

Working capital and working capital requirements will vary from time-to-time and will depend on numerous factors, including but not limited to, operating results, the level of resources devoted to research and development, new product introductions, grants from the Office of the Chief Scientist in Israel and marketing and acquisition activities.

We have in-balance sheet financial instruments and off-balance sheet contingent

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commitments. Our in-balance sheet financial instruments consist of our assets and liabilities. Our cash is invested in short-term (less than 3 months) U.S. dollars and NIS interest bearing deposits with banks. Our receivables' aging is between 60 to 70 days and our current liabilities' aging is approximately 60 days. The fair value of our financial instruments is similar to their book value. Our off-balance sheet contingent commitments consist of: (a) royalty commitments to the Israeli Office of the Chief Scientist that are directly related to our future revenues, (b) lease commitments of our premises and vehicles, (c) directors and officers' indemnities, in excess of the proceeds received from liability insurance which we obtain, and (d) legal proceedings.

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

B.O.S. BETTER ONLINE SOLUTIONS LTD AND ITS SUBSIDIARY.

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2004

U.S. DOLLARS IN THOUSANDS

UNAUDITED

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B.O.S. BETTER ONLINE SOLUTIONS LTD AND ITS SUBSIDIARY.

BALANCE SHEETS

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U.S. DOLLARS IN THOUSANDS

SEPTEMBER 30  
2004

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-----  
UNAUDITED  
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ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	\$ 5,098
Short-term marketable securities	1,936
Trade receivables (net of allowance for doubtful accounts of \$ 88 at September 30, 2004 and \$ 171 at December 31, 2003)	953
Other accounts receivable and prepaid expenses	250
Inventories (Note 5)	873
	-----
TOTAL current assets	9,110
	-----
LONG-TERM INVESTMENTS:	
Long-term marketable securities	554
Severance pay funds	729
Investment in an affiliated company	2,565
	-----
TOTAL long-term investments	3,848
	-----
PROPERTY AND EQUIPMENT, NET	615
	-----
INTANGIBLE ASSETS AND DEBT ISSUANCE COST:	
Goodwill	903
Other intangible assets	505
Debt issuance costs	207
	-----
TOTAL intangible assets	1,615
	-----
ASSETS RELATED TO DISCONTINUED SEGMENT (Note 4)	3
	-----
TOTAL assets	\$15,191
	=====

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

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B.O.S. BETTER ONLINE SOLUTIONS LTD AND ITS SUBSIDIARY.

BALANCE SHEETS

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U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

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SEPTEMBER  
2004  
-----  
UNAUDITED  
-----

LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Current maturities of long-term convertible note (Note 6)	\$ 50
Trade payables	60
Employees and payroll accruals	43
Deferred revenues	28
Accrued and other liabilities	98
	-----
TOTAL current liabilities	2,81
	-----
LONG-TERM LIABILITIES:	
Long-term convertible note (Note 6)	1,28
Accrued severance pay	1,01
	-----
TOTAL long-term liabilities	2,29
	-----
LIABILITIES RELATED TO DISCONTINUED SEGMENT (Note 4)	25
	-----
CONTINGENT LIABILITIES (Note 7)	
SHAREHOLDERS' EQUITY:	
Share capital -	
Ordinary shares of NIS 4.00 par value: Authorized: 8,750,000 shares at September 30, 2004 and December 31, 2003; Issued: 4,447,126 shares at September 30, 2004 and 4,167,509 at December 31, 2003; Outstanding: 4,447,126 shares at September 30, 2004 and 4,162,126 at December 31, 2003	4,55
Additional paid-in capital	43,71
Accumulated other comprehensive income	
Treasury shares (0 ordinary shares at September 30, 2004 and 5,383 Ordinary shares at December 31, 2003)	
Accumulated deficit	(38,44)
	-----
TOTAL shareholders' equity	9,83
	-----
TOTAL liabilities and shareholders' equity	\$ 15,19
	=====

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

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B.O.S. BETTER ONLINE SOLUTIONS LTD AND ITS SUBSIDIARY.

## CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

	NINE MONTHS ENDED SEPTEMBER 30,		THREE MONTHS SEPTEMBER
	2004	2003	2004
UNAUDITED			
Revenues	\$ 4,043	\$ 4,202	\$ 1,457
Cost of revenues	1,927	1,400	691
Non recurring royalty reversal	-	339	-
<b>Gross profit</b>	<b>2,116</b>	<b>3,141</b>	<b>766</b>
Operating expenses:			
Research and development	1,559	1,686	618
Less - grants and participation	(370)	(202)	(159)
Selling and marketing	933	1,934	296
General and administrative	1,152	1,020	337
Restructuring and related costs	-	592	-
<b>Total operating expenses</b>	<b>3,274</b>	<b>5,030</b>	<b>1,092</b>
Operating profit (loss)	(1,158)	(1,889)	(326)
Financial income (expenses), net	(51)	82	(59)
Other income, net	-	55	-
Income (loss) before equity in losses of an affiliated company	(1,209)	(1,752)	(385)
Equity in losses of an affiliated company	(215)	(341)	(81)
<b>Net income (loss) from continuing operations</b>	<b>(1,424)</b>	<b>(2,093)</b>	<b>(466)</b>
Net income (loss) related to discontinued operations (Note 4)	(18)	2,114	-
<b>Net income (loss)</b>	<b>\$ (1,442)</b>	<b>\$ 21</b>	<b>\$ (466)</b>
Basic and diluted net earnings (loss) per share from continuing operations	\$ (0.34)	\$ (0.58)	\$ (0.11)
Basic and diluted net earnings (loss) per share from discontinued operations	\$ (0.01)	\$ 0.59	\$ -



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	=====	=====	=====
Basic and diluted net earnings (loss) of NIS 4.00 par value per share	\$ (0.35)	\$ 0.01	\$ (0.11)
	=====	=====	=====
Weighted average number of shares used in computing basic and diluted net earnings (loss) per share	4,163,166	3,593,398	4,165,224
	=====	=====	=====

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

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B.O.S. BETTER ONLINE SOLUTIONS LTD AND ITS SUBSIDIARY.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

	NINE MONTHS ENDED SEPTEMBER 30,		THREE MONTH SEPTEMBER
	2004	2003	2004
	UNAUDITED		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ (1,442)	\$ 21	\$ (466)
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Net loss (income) from discontinued operations	18	(2,127)	-
Depreciation and amortization	320	500	120
Accrued severance pay, net	19	10	(2)
Capital loss from sale of property and equipment	-	-	-
Stock based compensation to service providers	90	26	27
Financial expenses related to warrants issued in connection with long-term convertible note	10	-	8
Equity in losses of an affiliated company	215	341	81
Decrease (increase) in trade receivables	122	410	(134)
Decrease (increase) in other accounts receivable and prepaid expenses	45	(171)	206
Decrease (increase) in inventories	88	(84)	26
Increase (decrease) in trade payables	144	(669)	60
Decrease in employees and payroll accruals, deferred revenues, accrued expenses and other liabilities	(317)	(792)	(214)

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Net cash used in continuing operations	(688)	(2,535)	(288)
Net cash used in operating activities from discontinued operations	(101)	(1,000)	(6)
	-----	-----	-----
Net cash used in operating activities	(789)	(3,535)	(294)
	-----	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	(158)	(94)	(80)
Proceeds from sale of property and equipment	-	6	-
Investment in long-term marketable securities	(678)	(886)	(400)
Redemption of marketable securities	1,000	801	600
Investment in an affiliated company	-	(155)	-
Realization of restricted cash	-	700	-
	-----	-----	-----
Net cash provided by investing activities	164	372	120
	-----	-----	-----

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

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B.O.S. BETTER ONLINE SOLUTIONS LTD AND ITS SUBSIDIARY.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

	NINE MONTHS ENDED SEPTEMBER 30,		THREE MONTHS SEPTEMBER
	2004	2003	2004
	UNAUDITED		
	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of shares	-	-	-
Proceeds from long-term convertible note and issuance of warrants, net of issuance expenses	1,805	-	(25)
Payment of long-term convertible note	(20)	-	(20)
Issuance expenses related to investment in an affiliated company	-	(159)	-
	-----	-----	-----
Net cash provided by (used in) financing activities from continuing operations	1,785	(159)	(45)
Net cash used in financing activities from			

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discontinued operations	-	(40)	-
	-----	-----	-----
Net cash provided by (used in) financing activities	1,785	(199)	(45)
	-----	-----	-----
Increase (decrease) in cash and cash equivalents	1,160	(3,362)	(219)
Decrease (increase) in cash and cash equivalents of discontinued operations	66	323	1
Cash and cash equivalents at the beginning of the period	3,872	5,246	5,316
	-----	-----	-----
Cash and cash equivalents at the end of the period	\$ 5,098	\$ 2,207	\$ 5,098
	=====	=====	=====
NON-CASH ACTIVITIES:			
Investment in an affiliated company against the issuance of shares	\$ -	\$ 1,755	\$ -
	=====	=====	=====
Issuance expenses related to convertible note	\$ 115	\$ -	\$ -
	=====	=====	=====
Purchase of property and equipment	\$ 13	\$ -	\$ -
	=====	=====	=====
Gain on available-for-sale marketable securities	\$ 4	\$ -	\$ 4
	=====	=====	=====
ACQUISITION OF QUASAR:			
The net fair value of assets acquired at date of acquisition was as follows:			
Working capital deficiency (excluding cash and cash equivalents)	\$ (147)	\$ -	\$ (147)
Property and equipment	76	-	76
Goodwill	162	-	162
Other intangible assets	505	-	505
	-----	-----	-----
	596	-	596
Less - amount acquired by issuance of shares	(539)	-	(539)
Less - accrued acquisition costs	(57)	-	(57)
	-----	-----	-----
	\$ -	\$ -	\$ -
	=====	=====	=====

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

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. DOLLARS IN THOUSANDS

### NOTE 1:- BASIS OF PRESENTATION

B.O.S. Better Online Solutions Ltd. is an Israeli corporation together with its subsidiaries (hereinafter "the Company" or "BOS"):

These unaudited interim condensed consolidated financial statements reflect the Company's financial position as of September 30, 2004 and for the year ended December 31, 2003. The statements also present the Company's statements of operations for the nine and three months ended September 30, 2004 and 2003 and for the year ended December 31, 2003, and the statements of cash flow for the nine and three months ended September 30, 2004 and 2003 and for the year ended December 31, 2003. The December 31, 2003 consolidated balance sheet, statement of operations and statements of cash flow data was derived from the Company's audited financial statements and does not include all of the disclosures required by accounting principles generally accepted in the United States. These interim statements include all normal recurring adjustments, which the Company believes are necessary to fairly present the Company's financial position. All material intercompany balances have been eliminated. Because all the disclosures required by accounting principles generally accepted in the United States are not included, these interim statements should be read in conjunction with the restated audited consolidated financial statements for the year ended December 31, 2003, included in the Company's annual report on Form 20-FA filed with the Securities and Exchange Commission on January 6, 2005. The statements of operations for the periods presented are not necessarily indicative of results for any future period, or for the entire year.

#### Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires the Company to base its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

### NOTE 2:- SHARE-BASED COMPENSATION

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB-25"), and Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" ("FIN 44"), in accounting for its employee stock option plan. Under APB-25, when the exercise price of the Company's employee stock options equals or is above than the market price of the underlying shares on the date of grant, no compensation expense is recognized.

The Company applies SFAS No. 123 and EITF 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction With, Selling, Goods or Services", with respect to warrants issued to non-employees. SFAS No. 123 requires the use of option valuation models to measure the fair value of the warrants at the date of grant.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 2:- SHARE-BASED COMPENSATION (CONT.)

Pro-forma disclosure is required by SFAS No. 123, had the compensation expense for stock options granted under the Company's plans, been determined based on the fair value at the date of grant. The Company's net loss and loss per Ordinary share in the nine months ended September 30, 2004 and 2003 and in the year ended December 31, 2003, would have changed to the pro forma amounts shown below:

	NINE MONTHS ENDED SEPTEMBER 30,		YEA DEC
	2004	2003	
	UNAUDITED		
Net loss from continuing operations as reported according to U.S. GAAP	\$ (1,424)	\$ (2,093)	\$
Deduct: stock-based compensation expense determined under fair value method for all awards	82	97	
Pro forma net loss from continuing operations	\$ (1,506)	\$ (2,190)	\$
Net income (loss) from discontinuing operations as reported according to U.S. GAAP	\$ (18)	\$ 2,114	\$
Deduct: stock-based compensation expense determined under fair value method for all awards	-	-	
Pro forma net income (loss) from discontinuing operations	\$ (18)	\$ 2,114	\$
Pro forma net (loss)	\$ (1,524)	\$ (76)	\$
Basic and diluted earning (loss) per share as reported according to U.S. GAAP:			
Continuing operations	\$ (0.34)	\$ (0.58)	\$
Discontinuing operations	\$ (0.01)	\$ 0.59	\$
Net income (loss)	\$ (0.35)	\$ 0.01	\$
Pro forma earning (loss) per share:			
Continuing operations	\$ (0.36)	\$ (0.61)	\$
Discontinuing operations	\$ (0.01)	\$ 0.59	\$
Net income (loss)	\$ (0.37)	\$ (0.02)	\$

=====

The fair value of each option granted is estimated on the date of grant, using the Black Scholes Option Pricing Model with expected volatility of approximately 47%, 71% and 64%, in the periods ended September 30, 2004, September 30, 2003 and December 31, 2003, respectively, and using the following weighted average assumptions:

- (1) Dividend yield of zero percent for each year.
- (2) Risk-free interest rate of 2.0 %, 1.5 % and 1.8% in the periods ended September 30, 2004 and 2003 and December 31, 2003, respectively.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 2:- SHARE-BASED COMPENSATION (CONT.)

- (3) Expected average lives of the options of three years from the date of grant in the periods ended September 30, 2004 and 2003 and December 31, 2003.

NOTE 3:- ACQUISITION OF QUASAR

In September 2004, the Company entered into an agreement with Quasar Communication Systems Ltd. ("Quasar"), to purchase the assets and liabilities of Quasar, for an aggregate purchase price of \$ 539 by issuance of shares. The value of the ordinary shares issued was determined based on the average market price of the Company's ordinary shares over the period including two days before and after the terms of the transaction were agreed to and announced. The results of Quasar's operations have been included in the consolidated financial statements since September 28, 2004 ("the closing date").

Quasar is an Israeli company engaged in the business of developing, manufacturing and selling of cellular communication gateways.

The acquisition will enable the Company to continue developing the communication division, while offering to the Company's clients an extended product line that will enable savings in telecommunication expenses for enterprise.

NOTE 3:- ACQUISITION OF QUASAR (CONT.)

The acquisition has been treated using the purchase method of accounting in accordance with FASB 141 "Business Combination". The purchase price has been allocated to the assets acquired based on their estimate fair value at the date of acquisition. The excess of the purchase price over the estimated fair value of the tangible and intangible assets acquired has been recorded as goodwill.

The financial statements reflect the purchase price of \$ 596, determined as follows:

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285,000 shares with a price of \$ 1.89	\$	539
transaction costs		57
		-----
	\$	596
		=====

Based on an analysis report prepared by management, the purchase price is allocated as follows:

ALLOCATION OF PURCHASE CONSIDERATION	VALUE AT SEPTEMBER 2004	ESTIMATED USEFUL LIFE
-----	-----	-----
Fixed assets	\$ 76	
Inventory purchase		
commitment liability	(147)	
Trade name	180	7 years
Current technology	125	5 years
Distribution networks	200	5 years
Goodwill	162	
	-----	
Total purchase price	\$ 596	
	=====	

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

The Company is committed to purchase Quasar's inventory in the ordinary course of business for a cash consideration of \$ 517. The fair value of Quasar's inventory at the purchase date amounted to \$ 370. A provision in the amount of \$ 147 has been recorded.

The Company's allocation of purchase price valued the acquired trade name using the relief from royalty approach.

The Company's allocation of purchase price valued the acquired current technology using the discounted cash flows to be derived from the sales of these products to present value.

The Company's allocation of purchase price valued the acquired distribution networks by calculating the savings realized by the Company through obtaining a pre-existing distribution network.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 3:- ACQUISITION OF QUASAR (CONT.)

The following unaudited pro forma financial information presents the Company's results of operations as if the acquisition had occurred as of the beginning of the fiscal years 2003 and 2004, after giving effect to certain adjustments, including amortization of intangible assets. The unaudited pro forma financial information does not necessarily reflect the results of operations that would have occurred, and is not necessarily indicative of results which may be obtained in the future.

	NINE MONTHS ENDED SEPTEMBER 30,		THREE MONTHS END SEPTEMBER 30,	
	2004	2003	2004	2003
			UNAUDITED	
Pro forma revenue	\$ 6,357	\$ 7,212	\$ 2,157	\$ 2,157
Pro forma net loss from continuing operations	\$ (1,868)	\$ (3,525)	\$ (639)	\$ (639)
Pro forma basic and diluted net loss per share from continuing operations	\$ (0.42)	\$ (0.91)	\$ (0.14)	\$ (0.14)

NOTE 4:- DISCONTINUED OPERATIONS

On June 1, 1998, the Company acquired 100% of the share capital of Pacific Information Systems Inc. ("Pacinfo"), a U.S. corporation. Pacinfo was a reseller of computer networking products. In April 2001, Pacinfo acquired Dean Technologies Associated LLC. ("DT"), a Texas limited liability company, which also operated in the computer-networking segment. In May 2002, the Board of Directors of the Company decided to sell all of Pacinfo's activities. During the fourth quarter of 2002, the Company initiated a plan to cease operations of Pacinfo and to proceed with a voluntary liquidation of Pacinfo.

The results of operations including revenues, operating expenses and other income and expenses of Pacinfo for the nine months ended September 30, 2004 and 2003 and the year ended December 31, 2003 have been presented in the accompanying statements of operations as discontinued operations.

The carrying amounts of the major classes of assets and liabilities included as part of the discontinued operations are:

SEPTEMBER 30, DECEMBER 31,



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	2004 ----- UNAUDITED -----	2003 -----
Cash	\$ 3	\$ 69
Other receivables and prepaid expenses	-	18
Property and equipment, net	-	32
	----	----
Assets of discontinued operations	\$ 3 =====	\$119 =====
Trade payables	\$200	\$299
Accrued expenses and other liabilities	54	75
	----	----
Liabilities of discontinued operations	\$254 =====	\$374 =====

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 4:- DISCONTINUED OPERATIONS (CONT.)

The results of operations, including revenues, cost of revenues and operating expenses of Pacinfo's operations for the nine months ended September 30, 2004 and 2003 and the year ended December 31, 2003 have been reclassified in the statements of operations.

Summarized selected financial information of the discontinued operations is as follows:

	NINE MONTHS ENDED SEPTEMBER 30, ----- 2004                      2003 ----- UNAUDITED -----		YEAR ENDED DECEMBER 31, 2003 -----
Revenues	\$ - =====	\$ 25 =====	\$ 25 =====
Net income (loss)	\$ (18) =====	\$2,114 =====	\$2,036 =====

NOTE 5:- INVENTORIES

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	SEPTEMBER 30, 2004	DECEMBER 31, 2003
	----- UNAUDITED -----	----- UNAUDITED -----
Raw materials (including packaging materials)	\$478	\$299
Products in progress	230	277
Finished products	165	385
	----	----
	\$873	\$961
	====	====

NOTE 6:- LONG-TERM CONVERTIBLE NOTE

On June 10, 2004, the Company entered into a Securities Purchase Agreement ("the Purchase Agreement"), with Laurus Master Fund Ltd. ("the Investor"), under which the Company issued to the Investor in a private placement (i) a Secured Convertible Term Note of a \$ 2,000 principal amount, due June 10, 2007 ("the Note"). According to the agreement, several fees in the amount of \$ 115 were paid to the Investor. Those fees are presented as discount of the principal convertible loan. The Note is convertible into Ordinary shares at a price of \$ 3.08 per share. The principal amount of the Note is repayable in monthly installments, commencing as of September, 2004, in the initial amount of \$ 20 eventually increasing to \$ 74. The Note bears prime interest rate plus 3% which subject to reduction in certain conditions(ii) a warrant to purchase 130,000 Ordinary shares at an exercise price of \$ 4.04 per share ("the Warrant"). The Warrant is exercisable, in whole or in part, until June 10, 2011. Any delay in registration and/or effectiveness of the underlying shares of the transaction, or failure to maintain their effectiveness, will result in penalties to be paid in cash, as liquidated damages, equal to 2.0% for each thirty (30) day period of the original principal amount of the note.

The note conversion price is subject to proportional adjustment in the event of stock splits, combinations, subdivisions of the ordinary shares or if dividend is paid on the ordinary shares in ordinary shares. In addition, if BOS issues stock in certain types of transactions at a price lower than the initial conversion price, then the conversion price will be adjusted to a lower price based on a weighted average formula.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 6:- LONG-TERM CONVERTIBLE NOTE (CONT.)

The fair value of the warrants was calculated using the Black Scholes Option Pricing Model with the following assumptions: a risk-free interest rate of 3.34%, a dividend yield of 0%, a volatility of the expected market price of the Company's Ordinary shares of 100% and a weighted-average contractual life of 7 year. The fair value of the warrants in the amount of \$ 99 is offset against the note, amortized over the period of the note and presented as a component in shareholders' equity.

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Aggregate portion:

	SEPTEMBER 30, 2004 ----- UNAUDITED -----
First year (current maturities)	\$ 508
Second year	883
Third year	589
	-----
	1,980
Less - discount	192
	-----
	\$1,788 =====

NOTE 7:- CONTINGENT LIABILITIES

- a. In July 2002, the Company received a claim letter from Operate Lease Ltd., ("Operate Lease") under which it claims that the Company's termination notice of the leasing agreement in March 2002 constitutes a breach of the agreement and Operate Lease is demanding compensation in which the nominal claim amount is \$ 292. No legal proceeding has yet been filed. At this stage, according to the Company's counsel assessment, the prospects of Operate Lease to prevail and recover a significant amount, seem remote. The financial statements do not include any provision in that regard.
  
- b. In 1998, as part of Pacinfo Share Purchase Agreement between the Company and Mr. Jacob Lee (the seller of Pacinfo who became a shareholder of the Company), certain actions involving Pacinfo, if occurred before the end of 2003, may trigger a tax event for Mr. Jacob Lee. The Company may be obligated, under certain assumptions and according to the purchase agreement, to grant Mr. Lee a loan on a full recourse basis for certain tax payments Mr. Lee may be liable for and reimburse Mr. Lee for certain interest on taxes that he may owe, estimated at approximately \$ 1,500. The Company will receive a security interest in shares of the Company that Mr. Lee holds at the time of the loan with a fair market value as of the date of the loan of at least 125% of the amount of the loan as security for the repayment of the loan.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

-----  
U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 8:- SEGMENTS AND GEOGRAPHIC INFORMATION

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- a. Subsequent to the liquidation of Pacinfo's operations in the computer networking segment, the Company manages its business on a basis of one reportable segment which consists of three product lines. Total revenues are attributed to geographic areas based on the location of customers in accordance with Statement of Financial Accounting No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131").

The following presents total revenues for the nine and three months ended September 30, 2004 and 2003 and for the year ended December 31, 2003:

	NINE MONTHS ENDED SEPTEMBER 30,		THREE MONTHS ENDED SEPTEMBER 30,		YEAR ENDED DECEMBER 31,
	2004	2003	2004	2003	2003
----- UNAUDITED -----					
United States	\$2,288	\$2,204	\$ 815	\$ 679	\$2,974
Europe	636	1,008	171	312	1,198
Israel	1,119	990	471	314	1,556
	-----	-----	-----	-----	-----
	\$4,043	\$4,202	\$1,457	\$1,305	\$5,728
	=====	=====	=====	=====	=====

- b. Product lines:

Total revenues from external customers divided on the basis of the Company's product lines are as follows:

	NINE MONTHS ENDED SEPTEMBER 30,		THREE MONTHS ENDED SEPTEMBER 30,		YEAR ENDED DECEMBER 31,
	2004	2003	2004	2003	2003
----- UNAUDITED -----					
Connectivity	\$3,107	\$3,507	\$1,085	\$1,036	\$4,670
Software utilities	443	323	152	141	492
Voice over IP	493	372	220	128	566
	-----	-----	-----	-----	-----
	\$4,043	\$4,202	\$1,457	\$1,305	\$5,728
	=====	=====	=====	=====	=====

- c. Long-lived assets:

SEPTEMBER 30,                      DECEMBER 31,

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	2004	2003	2003
	UNAUDITED		
United States	\$ -	\$ 10	\$ 5
Israel	2,023	1,352	1,334
	\$2,023	\$1,362	\$1,339
	=====	=====	=====

Long-lived assets comprise intangible assets and property and equipment.

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B.O.S. BETTER ONLINE SOLUTIONS LTD.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U.S. DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA

NOTE 8:- SEGMENTS AND GEOGRAPHIC INFORMATION (CONT.)

- d. Major customer's data as a percentage of total revenues:

	NINE MONTHS ENDED		YEAR ENDED
	SEPTEMBER 30,	2003	DECEMBER 31,
	2004		2003
	UNAUDITED		
Customer A	61%	52%	52%
	=====	=====	=====

NOTE 9:- SUBSEQUENT EVENTS

Acquisition of Odem:

On November 3, 2004, the Company entered into definitive share purchase agreements for the purchase of 63.8% of the issued and outstanding shares of Odem Electronic Technologies 1992 Ltd. ("Odem"), from Odem's existing shareholders. Odem, an Israeli private company, is a major solution provider and distributor of electronics components and advance technologies in the Israeli market. The closing of the transaction is subject to certain closing conditions.

In consideration of Odem's shares, the Company will issue (i) 290,532 of the Company's Ordinary shares; and (ii) will pay an amount of \$ 1,971 in cash.

In addition, Odem's selling shareholders and the Company have certain put and call options with respect to all of the remaining Odem shares

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held by such sellers, exercisable against consideration comprised of additional cash and issuance of additional Ordinary shares of the Company. The exercise prices of the written put options and the purchased call option are based on the valuation of Odem, ranging between \$ 4 million to \$ 6 million.. The Company's Ordinary shares issued are subject to "lock-up" periods of 2 to 4 years.

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### BOS BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARY

#### UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS

The following unaudited pro forma condensed combined financial statements have been prepared to give effect to the acquisitions by BOS Better Online Solutions Ltd. ("BOS") of Odem Electronic Technologies 1992 Ltd. ("Odem") and the assets purchase of Quasar Communication Systems Ltd. ("Quasar") under the purchase method of accounting after giving effect to the pro forma adjustments described in the accompanying notes.

The following unaudited pro forma condensed combined balance sheet as of September 30, 2004 gives effect to the acquisitions of substantially all the assets of Quasar and the share purchase of Odem, as if it had occurred on such date, and reflects the allocation of the purchase price to the Quasar and Odem, assets acquired based on their estimated fair values at the date of acquisitions. The excess of the consideration paid by BOS in the acquisitions over the fair value of Quasar and Odem, identifiable assets and liabilities has been recorded as goodwill.

The following unaudited pro forma condensed combined statements of operations combine the historical statements of operations of BOS, Quasar and Odem. The unaudited pro forma condensed combined statements of operations for the year ended December 31, 2003 and nine months ended September 30, 2004, give effect to the Quasar's and Odem's acquisitions as if it had occurred on January 1, 2003 and combine the historical unaudited statements of operations of BOS, Quasar and Odem, for such period. Integration costs are not included in the accompanying unaudited pro forma condensed combined financial statements. This pro forma information should be read in conjunction with the respective consolidated historical financial statements (including notes thereto) of BOS, Quasar and Odem, for the year ended December 31, 2003, and for the nine months ended September 30, 2004, appearing elsewhere herein.

Unaudited pro forma condensed combined financial information is presented for illustrative purposes only and is not necessarily indicative of the financial position or results of operations that would have actually been reported had the acquisitions occurred at the beginning of the periods presented, nor is it necessarily indicative of future financial position or results of operations. These unaudited pro forma condensed combined financial statements are based upon the respective historical financial statements of BOS, Quasar and Odem, and do not incorporate, nor do they assume, any benefits from cost savings or synergies of the combined company. The pro forma adjustments are based on available financial information and certain estimates and assumptions that BOS believes are reasonable and that are set forth in the notes to the unaudited pro forma condensed combined financial statements. In addition, the

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pro forma balance sheet includes allocations of the purchase price based upon preliminary estimates of the fair value of the assets and liabilities acquired. These allocations may be adjusted in the future upon finalization of these preliminary estimates.

In the end of September, 2004, we acquired all of the assets of Quasar which reflected in the historical balance sheet of BOS as of September 30, 2004.

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### BOS BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARY

#### UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2003

	BOS DECEMBER 31 ----- 2003 -----	QUASAR DECEMBER 31 ----- 2003 -----	ODEM DECEMBER 31 ----- 2003 -----
Revenues	5,728	3,971	8,261
Cost of revenues	1,794	3,732	6,736
Non recurring royalty reversal	(339)	-	-
	-----	-----	-----
Gross profit	4,273	239	1,525
	-----	-----	-----
Operating expenses:			
Research and development	2,129	-	-
Less - grants and participation	(283)	-	-
Selling and marketing	2,178	654	864
General and administrative	1,317	713	414
Restructuring and related costs	678	-	-
Amortization of intangible assets	-	-	-
	-----	-----	-----
Total operating expenses	6,019	1,367	1,278
	-----	-----	-----
Operating profit (loss)	(1,746)	(1,128)	247
Financial income (expenses), net	109	(86)	(112)
Other income (expenses), net	45	-	-
	-----	-----	-----
Income (loss) before tax on income	(1,592)	(1,214)	135
Tax on income	-	(237)	(61)
	-----	-----	-----
Net earning (loss) after tax on income	(1,592)	(1,451)	74
Equity in losses of an affiliated company	(465)	-	-
Minority interest in earnings in a			

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subsidiary	-	-	-
	-----	-----	-----
Net earning (loss) from continuing segments	(2,057)	(1,451)	74
	=====	=====	=====
Basic and diluted net loss per share from continuing segment	\$ (0.56)		
	=====		
Weighted average number of shares used in computing basic and diluted net loss per share	3,683,058		
	=====		

	PRO FORMA			
	QUASAR	ODEM	TOTAL	REFERENCE
	-----	-----	-----	-----
Revenues	-	-	-	
Cost of revenues	-	-	-	
Non recurring royalty reversal	-	-	-	
	-----	-----	-----	
Gross profit	-	-	-	
	-----	-----	-----	
Operating expenses:				
Research and development	-	-	-	
Less - grants and participation	-	-	-	
Selling and marketing	-	-	-	
General and administrative	-	-	-	
Restructuring and related costs	-	-	-	
Amortization of intangible assets	91	141	232	(i), (k)
	-----	-----	-----	
Total operating expenses	91	141	232	
	-----	-----	-----	
Operating profit (loss)	(91)	(141)	(232)	
Financial income (expenses), net	-	-	-	
Other income (expenses), net	-	-	-	
	-----	-----	-----	
Income (loss) before tax on income	(91)	(141)	(232)	
Tax on income	-	51	51	(j)
	-----	-----	-----	
Net earning (loss) after tax on income	(91)	(90)	(181)	
Equity in losses of an affiliated company	-	-	-	
Minority interest in earnings in a				



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subsidiary	-	(27)	(27)	(1)
	-----	-----	-----	
Net earning (loss) from continuing segments	(91)	(117)	(208)	
	=====	=====	=====	
Basic and diluted net loss per share from continuing segment				
Weighted average number of shares used in computing basic and diluted net loss per share				

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BOS BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARY

UNAUDITED PRO FORMA CONDENSED COMBINED BALANCE SHEET AS OF SEPTEMBER 30, 2004

	BOS SEPTEMBER 30, 2004	ODEM SEPTEMBER 30, 2004	PRO FORMA
ASSETS	----- (Unaudited)	----- (Unaudited)	-----
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	5,098	201	(2,091)
Marketable securities	1,936	-	-
Trade receivables, net	953	3,698	-
Other accounts receivable and prepaid expenses	250	353	-
Inventory	873	1,400	-
	-----	-----	-----
TOTAL CURRENT ASSETS	9,110	5,652	(2,091)
	-----	-----	-----
<b>LONG-TERM INVESTMENTS</b>			
Long-term marketable securities	554	-	-
Deferred income tax	-	36	-
Severance pay fund	729	316	-
Investment in a company	2,565	-	-
	-----	-----	-----
TOTAL LONG-TERM INVESTMENTS	3,848	352	-
	-----	-----	-----
PROPERTY AND EQUIPMENT, NET	615	461	-
	-----	-----	-----
<b>INTANGIBLE ASSETS AND DEBT ISSUANCE COST:</b>			
Goodwill	903	-	527
Other intangible assets	505	-	1,636
Debt issuance costs	207	-	-
	-----	-----	-----
TOTAL INTANGIBLE ASSETS AND DEBT ISSUANCE COST	1,615	-	2,163

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ASSETS RELATED TO DISCONTINUED OPERATIONS	3	-	-
	-----	-----	-----
TOTAL ASSETS	15,191	6,465	72
	=====	=====	=====

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BOS BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARY  
 UNAUDITED PRO FORMA CONDENSED COMBINED BALANCE SHEET AS OF  
 SEPTEMBER 30, 2004 (CONT.)

	BOS SEPTEMBER 30, 2004 ----- (Unaudited)	ODEM SEPTEMBER 2004 ----- (Unaudited)
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term bank loans and convertible note	508	61
Short term bank loans	-	1,325
Trade payables	608	2,068
Employees and payroll accruals	433	190
Deferred revenues	281	-
Accrued expenses and other liabilities	981	59
	-----	-----
TOTAL CURRENT LIABILITIES	2,811	3,703
	-----	-----
LONG-TERM LIABILITIES:		
Long-term bank loans and convertible note	1,280	63
Put option issued to minority shareholders in a subsidiary	-	-
Deferred tax	-	-
Accrued severance pay	1,015	368
	-----	-----
TOTAL LONG TERM LIABILITIES	2,295	431
	-----	-----
MINORITY RIGHTS IN A SUBSIDIARY	-	-
	-----	-----
LIABILITIES RELATED TO DISCONTINUED OPERATIONS	254	-
	-----	-----
SHAREHOLDERS' EQUITY		
TOTAL SHAREHOLDERS' EQUITY	9,831	2,331
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	15,191	6,465
	=====	=====

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BOS BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARY

UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF OPERATIONS FOR THE  
NINE MONTHS ENDED SEPTEMBER 30, 2004

	BOS	QUASAR	ODEM
	-----	-----	-----
	NINE MONTHS	NINE MONTHS	NINE MONTHS
	ENDED	ENDED	ENDED
	SEPTEMBER 30,	SEPTEMBER	SEPTEMBER
	2004	30, 2004	30, 2004
	-----	-----	-----
Revenues	4,043	2,314	11,644
Cost of revenues	1,927	1,916	9,605
Non recurring royalty reversal	-	-	-
	-----	-----	-----
Gross profit	2,116	398	2,039
	-----	-----	-----
Operating expenses:			
Research and development	1,559	-	-
Less - grants and participation	(370)	-	-
Selling and marketing	933	259	1,013
General and administrative	1,152	468	398
Amortization of intangible assets	-	-	-
	-----	-----	-----
Total operating expenses	3,274	727	1,411
	-----	-----	-----
Operating profit (loss)	(1,158)	(329)	628
Financial income (expenses), net	(51)	(47)	(143)
	-----	-----	-----
Income (loss) before tax on income	(1,209)	(376)	485
Tax on income	-	-	(178)
	-----	-----	-----
Net earning (loss) after tax on income	(1,209)	(376)	307
Equity in losses of an affiliated company	(216)	-	-
Minority interest in earnings in a subsidiary	-	-	-
	-----	-----	-----
Net earning (loss) from continuing segments	(1,425)	(376)	307
	=====	=====	=====
Basic and diluted net loss per share from continuing segment	\$ (0.34)		
	=====		
Weighted average number of shares used in computing basic and diluted net loss per share	4,163,166		
	=====		

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	PRO FORMA			REFERENCE
	QUASAR	ODEM	TOTAL	
Revenues	-	-	-	
Cost of revenues	-	-	-	
Non recurring royalty reversal	-	-	-	
Gross profit	-	-	-	
Operating expenses:				
Research and development	-	-	-	
Less - grants and participation	-	-	-	
Selling and marketing	-	-	-	
General and administrative	-	-	-	
Amortization of intangible assets	68	105	173	(i), (k)
Total operating expenses	68	105	173	
Operating profit (loss)	(68)	(105)	(173)	
Financial income (expenses), net	-	-	-	
Income (loss) before tax on income	(68)	(105)	(173)	
Tax on income	-	37	37	(j)
Net earning (loss) after tax on income	(68)	(68)	(136)	
Equity in losses of an affiliated company	-	-	-	
Minority interest in earnings in a subsidiary	-	(111)	(111)	(l)
Net earning (loss) from continuing segments	(68)	(179)	(247)	
Basic and diluted net loss per share from continuing segment				
Weighted average number of shares used in computing basic and diluted net loss per share				

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### BOS BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARY

NOTE 1:- GENERAL

The unaudited pro forma condensed combined financial statements reflect the following:

- a. The purchase of assets of Quasar Communication Systems Ltd. ("Quasar"). BOS purchased the majority of Quasar's assets relating to Quasar's business, including its property and equipment, technology, trade name and existing distribution channels. In consideration for the acquired assets, the Company has issued Quasar 285,000 Ordinary Shares, which are subject to a "lock-up" period of one year.

The Company also committed to purchase Quasar's inventory in the ordinary course of business, for cash consideration equal to the book value of Quasar's inventory amounting to \$ 517.

The purchase consideration was estimated as follows:

Issuance of shares (1)	\$ 539
Transaction cost	57
	-----
Total consideration	\$ 596
	=====

- (1) The value of the ordinary shares issued was determined based on the average market price of the Company's ordinary shares over the period including two days before and after the terms of the transaction were agreed to and announced.

Based on an analysis report prepared by management, the purchase price is allocated as follows:

	SEPTEMBER 28, 2004
ALLOCATION OF PURCHASE CONSIDERATION	-----
Tangible assets acquired	\$ 76
Inventory purchase commitment liability	(147)
Intangible assets	
Trade name	180
Current technology	125
Distribution network	200
Goodwill	162
	-----
Total consideration	\$ 596
	=====

- b. The share purchase of Odem Electronic Technologies 1992 Ltd. ("Odem"), from Odem's existing shareholders. In consideration for 63.8% of Odem's shares the Company (i) will issue 290,532 of the Company's

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ordinary shares and (ii) will pay an amount of \$ 1,971 in cash.

In addition, the Odem's selling shareholders and the Company has certain put and call options with respect to all of the remaining Odem shares held by such sellers, exercisable against consideration comprised of additional cash and issuance of additional ordinary shares of the Company. The Company's ordinary shares issued are subject to "lock-up" periods of 2 to 4 years.

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### BOS BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARY

#### NOTE 1:- GENERAL (CONT.)

The purchase consideration was estimated as follows:

Cash consideration	\$ 1,971
Estimated transaction costs	120
Issuance of shares (1)	770
	-----
Total consideration	\$ 2,861
	=====

(1) The value of the ordinary shares issued was determined based on the average market price of the Company's ordinary shares over the period including two days before and after the terms of the transaction were agreed to and announced.

Based upon a preliminary valuation of tangible and intangible assets acquired, BOS has allocated the total cost of the acquisition to Odem's assets as follows. (This allocation is for pro forma purposes only. Actual fair values will be based on the fair value of the net assets purchased as of November 17, 2004):

ALLOCATION OF PURCHASE CONSIDERATION	SEPTEMBER 30, 2004
	-----
Tangible assets acquired	\$ 1,487
Options	
Put option to minority shareholders	(359)
Call option to minority shareholders	230
Intangible assets	
Customer base	1,406
Deferred tax liability	(430)
Goodwill	527
	-----
Total consideration	\$ 2,861

=====

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill arising from acquisitions will not be amortized. In lieu of amortization, BOS is required to perform an annual and interim impairment review. If BOS determines, through the impairment review process, that goodwill has been impaired, it will record the impairment charge in its statement of operations. BOS will also assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

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BOS BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARY

NOTE 2: - PRO-FORMA

The pro forma condensed combined balance sheet includes the adjustments necessary to give effect to the acquisitions as if it had occurred on January 1, 2003 and to reflect the allocation of the acquisitions cost to the fair value of tangible and intangible assets acquired as noted above, including the elimination of Quasar's equity account and Odem's equity account.

Adjustments included in the pro forma condensed combined balance sheet are summarized as follows:

- a) Cash consideration paid for Odem Incorporated was estimated as follows:

Cash consideration		\$ 1,971
Estimated transaction costs		120
		-----
Total consideration		\$ 2,091
		=====

- b) Valuation of Odem's intangible assets allocated to customers base, and goodwill at the amount of \$ 1,406 and \$ 527 respectively.
- c) Valuation of Call options to Odem's sellers at the amount of \$ 230 presented in other intangible assets.
- d) Valuation of deferred tax liabilities amounted to \$ 430.
- e) Valuation of Put options to Odem's sellers at the amount of \$ 359.
- f) Elimination of the Odem Equity at the amount of \$ 2,331.
- g) Issuance of 290,532 Ordinary shares valued at \$770.
- h) The minority rights in a subsidiary of 36.2% amounted to \$ 844.
- i) Amortization of Odem's intangible assets of \$ 141 and \$ 105 for the

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year ended December 31, 2003 and for the nine-month period ended September 30, 2004.

- j) Deferred tax benefit on account of amortization of intangible assets of \$ 51 and \$ 37 for the year ended December 31, 2003 and for the nine-month period ended September 30, 2004.
- k) Amortization of Quasar's intangible assets of \$ 91 and \$ 68 for the year ended December 31, 2003 and for the nine-month period ended September 30, 2004 respectively.
- l) Minority interest in earnings in Odem of 36.2% amounted to \$ 27 and \$ 111 for the year ended December 31, 2003 and for the nine-month period ended September 30, 2004 respectively.

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### BOS BETTER ONLINE SOLUTIONS LTD. AND ITS SUBSIDIARY

#### NOTE 3- AMORTIZATION OF INTANGIBLE ASSETS

Amortization of acquired intangible assets is calculated using the following estimated useful lives:

	YEARS -----
Current Technology	5
Distribution network	5
Customer base	10
Trade name	7
Goodwill	Indefinite

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### SURF-COMMUNICATION SOLUTIONS LTD. AND SUBSIDIARIES

#### INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2004

IN U.S. DOLLARS

UNAUDITED

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### SURF-COMMUNICATION SOLUTIONS LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

-----  
 U.S. DOLLARS IN THOUSANDS

	SEPTEMBER 30, 2004 ----- UNAUDITED -----	DECEMBER 2003 -----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$1,945	\$3,552
Short-term deposits	1,102	1,124
Trade receivables (net of allowance for doubtful accounts of \$ 52 at September 30, 2004 and December 31, 2003)	493	434
Other accounts receivable	250	229
	-----	-----
TOTAL current assets	3,790	5,339
	-----	-----
LONG-TERM INVESTMENTS:		
Long-term deposits	60	34
Severance pay fund	389	388
	-----	-----
TOTAL long-term investments	449	422
	-----	-----
PROPERTY AND EQUIPMENT, NET	409	471
	-----	-----
	\$4,648	\$6,232
	=====	=====

The accompanying notes are an integral part of the consolidated financial

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statements.

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SURF-COMMUNICATION SOLUTIONS LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. DOLLARS IN THOUSANDS (EXCEPT FOR SHARE DATA)

	SEPTEMBER 30, 2004 ----- UNAUDITED -----
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Trade payables	\$ 227
Accrued expenses and other liabilities	694
	-----
TOTAL current liabilities	921
	-----
LONG-TERM LIABILITIES:	
Accrued severance pay	476
	-----
SHAREHOLDERS' EQUITY:	
Ordinary shares of NIS 0.01 par value:	
Authorized: 15,631,286 shares at September 30, 2004 and December 31, 2003; Issued and outstanding: 1,089,846 and 1,055,471 shares at September 30, 2004 and December 31, 2003, respectively	
	3
Preferred shares of NIS 0.01 par value:	
Authorized: 4,368,714 shares at September 30, 2004 and December 31, 2003; Issued and outstanding: 3,300,034 shares at September 30, 2004 and December 31, 2003; Aggregate liquidation preference of \$ 43,063 at September 30, 2004	
	7
Additional paid-in capital	30,881
Deferred stock compensation	(142)
Accumulated deficit	(27,498)
	-----
TOTAL shareholders' equity	3,251
	-----
	\$ 4,648
	=====

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

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## SURF-COMMUNICATION SOLUTIONS LTD. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. DOLLARS IN THOUSANDS

	NINE MONTHS ENDED SEPTEMBER 30,		THREE MONTHS ENDED SEPTEMBER 30,	
	2004	2003	2004	2003
	----- UNAUDITED -----			
Revenues:				
Software licenses	\$ 1,672	\$ 831	\$ 261	\$ 310
Royalties	321	66	213	15
	-----	-----	-----	-----
TOTAL revenues	1,993	897	474	325
	-----	-----	-----	-----
Cost of revenues:				
Software licenses	475	359	132	106
Royalties	39	26	6	9
	-----	-----	-----	-----
TOTAL cost of revenues	514	385	138	115
	-----	-----	-----	-----
Gross profit	1,479	512	336	210
	-----	-----	-----	-----
Operating expenses:				
Research and development, net	1,096	1,598	253	422
Selling and marketing, net	1,273	1,029	415	338
General and administrative	472	475	186	190
Non-recurring costs	-	102	-	-
	-----	-----	-----	-----
TOTAL operating expenses	2,841	3,204	854	950
	-----	-----	-----	-----
Operating loss	1,362	2,692	518	740
Financial expenses (income), net	11	(59)	(2)	(14)
	-----	-----	-----	-----
Loss before income taxes	1,373	2,633	516	726
Income taxes	-	-	-	-
	-----	-----	-----	-----
Net loss	\$ 1,373	\$ 2,633	\$ 516	\$ 726
	=====	=====	=====	=====

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

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SURF-COMMUNICATION SOLUTIONS LTD. AND SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. DOLLARS IN THOUSANDS (EXCEPT FOR SHARE DATA)

	ORDINARY SHARES		PREFERRED SHARES		ADDITIONAL PAID-IN CAPITAL	DETAILED COMP
	SHARES	AMOUNT	SHARES	AMOUNT		
Balance as of January 1, 2003	965,000	\$ 3	3,300,034	\$ 7	\$ 30,773	\$
Deferred compensation related to options issued to employees	-	-	-	-	108	
Amortization of deferred stock compensation	-	-	-	-	-	
Exercise of stock options	90,471	*)	-	-	-	
Net loss	-	-	-	-	-	
Balance as of December 31, 2003	1,055,471	3	3,300,034	7	30,881	
Amortization of deferred stock compensation	-	-	-	-	-	
Exercise of stock options	34,375	*)	-	-	-	
Net loss	-	-	-	-	-	
Balance as of September 30, 2004 (unaudited)	1,089,846	\$ 3	3,300,034	\$ 7	\$ 30,881	\$

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

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SURF-COMMUNICATION SOLUTIONS LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. DOLLARS IN THOUSANDS

NINE MONTHS ENDED SEPTEMBER 30,		YEAR ENDED DECEMBER 31,
2004	2003	2003
UNAUDITED		

CASH FLOWS FROM OPERATING ACTIVITIES:

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Net loss	\$ (1,373)	\$ (2,633)	\$ (3
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	153	289	
Increase in accrued severance pay, net	3	-	
Amortization of deferred stock compensation	39	108	
Interest income (expenses) from short-term deposits	22	1	
Decrease (increase) in trade receivables	(59)	167	
Increase in other accounts receivable	(21)	(30)	
Increase (decrease) in trade payables	94	(36)	
Increase (decrease) in accrued expenses and other liabilities	(348)	(44)	
	-----	-----	---
Net cash used in operating activities	(1,490)	(2,178)	(2
	-----	-----	---
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	(91)	(20)	
Long-term deposits	-	51	
Short-term deposit	(26)	-	(1
	-----	-----	---
Net cash provided by (used in) investing activities	(117)	31	
	-----	-----	---
Decrease in cash and cash equivalents	(1,607)	(2,147)	(3
Cash and cash equivalents at the beginning of the period	3,552	7,048	7
	-----	-----	---
Cash and cash equivalents at the end of the period	\$ 1,945	\$ 4,901	\$ 3
	=====	=====	=====

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

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SURF-COMMUNICATION SOLUTIONS LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1:- GENERAL

Surf-Communication Solutions Ltd. ("the Compa