Kornit Digital Ltd.
Form 20-F
March 26, 2019

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 20-F**

**(Mark One)**

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

**OR**

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

**For the fiscal year ended December 31, 2018**

**OR**

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

**OR**

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

**Commission file number 001-36903**

**KORNIT DIGITAL LTD.**

(Exact name of Registrant as specified in its charter)

**Israel**

(Jurisdiction of incorporation or organization)

**12 Ha'Amal St.**

**Rosh-Ha'Ayin 4809246, Israel**

(Address of principal executive offices)

**Guy Avidan**

**Chief Financial Officer**

**Kornit Digital Ltd.**

**12 Ha'Amal St.**

**Rosh-Ha'Ayin 4809246, Israel**

**Tel: +972 3 908-5800**

**Fax: +972 3 908-0280**

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| **Ordinary shares, par value NIS 0.01 per share** | **The Nasdaq Stock Market LLC** |

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: As of December 31, 2018, the registrant had outstanding:

35,065,200 ordinary shares, par value NIS 0.01 per share

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

**Yes** **No**

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

**Yes** **No**

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 whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

**Yes** **No**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See definition of “large accelerated filer, “accelerated filer,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

| Large accelerated filer: | Accelerated filer: | Non-accelerated filer:<br>Emerging growth company: |
|---|---|---|

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards† provided pursuant to Section 13(a) of the Exchange Act.

† The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

| U.S. GAAP | International Financial Reporting Standards as issued by the International Accounting Standards Board | Other |
|---|---|---|

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

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

**Yes** **No**

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Certain information included or incorporated by reference in this annual report on Form 20-F may be deemed to be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are often characterized by the use of forward-looking terminology such as "may," "will," "expect," "anticipate," "estimate," "continue," "believe," "should," "intend," "project" or other similar words, but are not the o these statements are identified.

These forward-looking statements may include, but are not limited to, statements relating to our objectives, plans and strategies, statements that contain projections of results of operations or of financial condition and all statements (other than statements of historical facts) that address activities, events or developments that we expect, project, believe, anticipate, intend or project will or may occur in the future. The statements that we make regarding the following matters are forward-looking by their nature:

- our expectations regarding the expansion of our servable addressable market;
- our expectations regarding our future gross margins and operating expenses;
- our expectations regarding our growth and overall profitability;
- our expectations regarding the impacts of variability on our future revenues;
- our expectations regarding drivers of our future growth, including anticipated sales growth, penetration of new markets, and expansion of our customer base;
- our plans to continue our expansion into new product markets;
- our plans to continue to invest in research and development to introduce new systems and improved solutions;
- our plans regarding our distribution strategy for our products;
- our plans related to the development of our new, modern manufacturing facility in Kiryat Gat, Israel;
- our expectations regarding the success of our new products and systems;
- the impact of government laws and regulations;
- our expectations regarding our anticipated cash requirements for the next 12 months;
- our plans to expand our international operations;

our plans to file and procure additional patents relating to our intellectual property rights and the adequate protection of these rights;

our plans to pursue strategic acquisitions or invest in complementary companies, products or technologies; and

our expectations regarding the time during which we will be an emerging growth company under the JOBS Act.

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The preceding list is not intended to be an exhaustive list of all of our forward-looking statements. The forward-looking statements are based on our beliefs, assumptions and expectations of future performance, taking into account the information currently available to us. These statements are only predictions based upon our current expectations and projections about future events. There are important factors that could cause our actual results, levels of activity, performance or achievements to differ materially from the results, levels of activity, performance or achievements expressed or implied by the forward-looking statements. In particular, you should consider the risks described in “ITEM 3.D Risk Factors,” “ITEM 4 Information on the Company,” and “ITEM 5 Operating and Financial Review and Prospects.”

You should not rely upon forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance and events and circumstances reflected in the forward-looking statements will be achieved or will occur.

**USE OF TRADE NAMES**

Throughout this annual report, we refer to various trademarks, service marks and trade names that we use in our business. The “Kornit Digital” design logo, the “K” logo and other trademarks or service marks of Kornit Digital Ltd. appearing in this annual report are the property of Kornit Digital Ltd. We have several other registered trademarks, service marks and pending applications relating to our solutions. Although we have omitted the “®” and “™” trademark designations for such marks in this annual report, all rights to such trademarks are nevertheless reserved. Other trademarks and service marks appearing in this annual report are the property of their respective holders. We do not intend our use or display of other companies’ tradenames, trademarks or service marks to imply a relationship with, or endorsement or sponsorship of us by, these other companies.

**CERTAIN ADDITIONAL TERMS AND CONVENTIONS**

In this annual report, unless the context otherwise requires:

- references to “Kornit Digital,” “our company,” “the Company,” “the registrant,” “we,” “us,” and “our” refer to Kornit Digital
- references to “ordinary shares”, “our shares” and similar expressions refer to the Company’s Ordinary Shares, par value NIS 0.01 per share;
- references to “dollars”, “U.S. dollars”, “U.S. $” and “$” are to United States Dollars;

references to "shekels" and "NIS" are to New Israeli Shekels, the Israeli currency;

references to "GAAP" are to U.S. Generally Accepted Accounting Principles;

references to our "articles" are to our Articles of Association, as amended;

references to the "Companies Law" are to the Israeli Companies Law, 5759-1999, as amended;

references to the "Securities Act" are to the U.S. Securities Act of 1933, as amended;

references to the "Exchange Act" are to the U.S. Securities Exchange Act of 1934, as amended;

references to "NASDAQ" are to the NASDAQ Stock Market; and

references to the "SEC" are to the United States Securities and Exchange Commission.

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**PART I**

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

Not Applicable.

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

Not Applicable.

**ITEM 3. Key Information.**

**A. Selected Financial Data**

The following tables set forth our selected consolidated financial data. You should read the following selected consolidated financial data in conjunction with, and it is qualified in its entirety by reference to, our historical financial information and other information provided in this annual report, including “ITEM 5 - Operating and Financial Review and Prospects” and our consolidated financial statements and the related notes appearing elsewhere in this annual report.

The selected consolidated statements of income data for the years ended December 31, 2016, 2017 and 2018 and selected consolidated balance sheet data as of December 31, 2017 and 2018 are derived from our audited consolidated financial statements appearing in ITEM 18. Financial Statements. The selected consolidated statements of income data for the years ended December 31, 2014 and 2015 and the selected consolidated balance sheet data as of December 31, 2014, 2015 and 2016 has been derived from our audited consolidated financial statements not appearing in this annual report. The historical results set forth below are not necessarily indicative of the results to be expected in future periods. Our financial statements have been prepared in accordance with GAAP.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (in thousands, except share and per share data) | | | | |
| Consolidated Statements of Income: | | | | | |
| Revenues | $66,364 | $86,405 | $108,694 | $114,088 | $142,373 |

| | | | | | |
|---|---|---|---|---|---|
| Cost of revenues[1] | 37,187 | 45,820 | 59,284 | 59,977 | 72,504 |
| Gross profit | 29,177 | 40,585 | 49,410 | 54,111 | 69,869 |
| Operating expenses: | | | | | |
| Research and development[1] | 9,475 | 11,950 | 17,383 | 20,834 | 21,912 |
| Sales and marketing[1] | 10,616 | 13,367 | 18,338 | 21,279 | 25,596 |
| General and administrative[1] | 5,266 | 9,500 | 12,259 | 13,578 | 16,436 |
| Restructuring expenses | - | - | - | 503 | 321 |
| Total operating expenses | 25,357 | 34,817 | 47,980 | 56,194 | 64,265 |
| Operating income (loss) | 3,820 | 5,768 | 1,430 | (2,083) | 5,604 |
| Finance income (expenses), net | (15) | (334) | 46 | 452 | 1,433 |
| Income (loss) before taxes on income (tax benefit) | 3,805 | 5,434 | 1,476 | (1,631) | 7,037 |
| Taxes on income (tax benefit) | 782 | 709 | 648 | 384 | (5,392) |
| Net income (loss) | 3,023 | $4,725 | $828 | $(2,015) | $12,429 |
| Net earnings (loss) per ordinary share[2] | | | | | |
| Basic | $0.34 | $0.19 | $0.03 | $(0.06) | $0.36 |
| Diluted | $0.29 | $0.18 | $0.03 | $(0.06) | $0.35 |
| Weighted average number of ordinary shares used in computing income per ordinary share[2] | | | | | |
| Basic | 8,969,588 | 24,633,369 | 30,562,255 | 33,574,147 | 34,521,352 |
| Diluted | 10,446,329 | 26,458,584 | 31,732,532 | 33,574,147 | 35,363,704 |

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| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (in thousands) | | | | |
| Consolidated balance sheet data: | | | | | |
| Cash and cash equivalents | $4,993 | $18,464 | $22,789 | $18,629 | $74,132 |
| Working capital[(3)] | 14,863 | 65,455 | 68,651 | 63,907 | 107,584 |
| Total assets | 34,714 | 123,352 | 140,046 | 178,374 | 214,823 |
| Total long term liabilities | 2,025 | 1,839 | 2,725 | 2,155 | 2,515 |
| Total shareholders' equity | 19,351 | 100,262 | 107,188 | 150,699 | 179,136 |

(1) Includes share-based compensation expense as follows:

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (in thousands) | | | | |
| Share-based compensation expense: | | | | | |
| Cost of revenues | $96 | $306 | $482 | $629 | $892 |
| Research and development | 86 | 281 | 217 | 775 | 1,022 |
| Sales and marketing | 207 | 537 | 654 | 920 | 1,240 |
| General and administrative | 508 | 1,259 | 1,640 | 2,087 | 2,392 |
| Total share-based compensation expense | $897 | $2,383 | $2,993 | $4,411 | $5,546 |

(2) Basic and diluted net earnings per ordinary share is computed based on the basic and diluted weighted average number of ordinary shares outstanding during each period. For additional information, see notes 2z and 11 to our consolidated financial statements included in ITEM 18. Financial Statements.

(3) Working capital is defined as total current assets minus total current liabilities. In November 2015, the Financial Accounting Standards Board, or the FASB, issued Accounting Standards Update No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes (ASU 2015-17), which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities to be classified as noncurrent on the balance sheet. We early adopted this standard in 2015 retrospectively and reclassified all of our current deferred tax assets to noncurrent deferred tax assets which has resulted in a change to previously published working capital amounts for the year ended December 31, 2014.

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**B. Capitalization and Indebtedness**

Not applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not applicable.

**D. Risk Factors**

*Our business involves a high degree of risk. Please carefully consider the risks we describe below in addition to the other information set forth in this annual report and in our other filings with the SEC. These risks could materially and adversely affect our business, financial condition and results of operations. See "Cautionary Note Regarding Forward-Looking Statements."*

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

***If the market for digital textile printing does not develop as we anticipate, our sales may not grow as quickly as expected and our share price could decline.***

The global printed textile industry is currently dominated by analog printing processes, the most common of which are screen printing and carousel printing. If the global printed textile industry does not more broadly accept digital printing as an alternative to analog printing, our revenues may not grow as quickly as expected, or may decline, and our share price could suffer. Widespread adoption of digital textile printing depends on the willingness and ability of businesses in the printed textile industry to replace their existing analog printing systems with digital printing systems. These businesses may decide that digital printing processes are less reliable, less cost-effective, of lower quality, or otherwise less suitable for their commercial needs than analog printing processes. For example, screen printing currently tends to be faster and less expensive than digital printing on a cost per print basis for larger production runs. Even if businesses are persuaded as to the benefits of digital printing, we do not know whether potential buyers of digital printing systems will delay their investment decisions. As a result, we may not correctly estimate demand for our solutions, which could cause us to fail to meet customer needs in a timely manner or fail to take advantage of economies of scale in the production of our solutions.

***Our results of operations will be adversely impacted by our failure to timely introduce new products, or to achieve market acceptance or gain adequate market share for new or existing products.***

Our ability to develop innovative new systems and products is important to our business strategy and competitive position. Difficulties or delays in research, development, production or commercialization of new systems and products could adversely impact our sales and competitive position. We cannot ensure that the significant investments that we have made in distribution, sales and customer service teams to launch the new systems will enable us to successfully market, sell and distribute the systems as planned. Market acceptance of the new systems will depend on, among other things, the systems demonstrating a real advantage over existing printers, the success of our sales and marketing teams in creating awareness of the systems, the sales price and the return on investment of the systems relative to alternative printers, customer recognition of the value of our technology, the effectiveness of our marketing campaigns, and the general willingness of potential customers to try new technologies. If we fail to develop and launch new systems and products, experience cost overruns in connection with such development, or the market does not accept our new systems and products, our business, results of operations and financial condition would be adversely affected. Even if we are successful in selling our new systems which provide greater efficiency and lower cost per print, sales of ink and other consumables per system may decrease, which may adversely affect our results of operations, including gross margin and overall profitability.

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***If our customers use alternative ink and consumables and/or alternative spare parts in our systems, our gross margin could decline significantly, and our business could be harmed.***

Our business model benefits significantly from recurring sales of our ink and other consumables and spare parts for our existing and growing installed base of systems. Third parties could try to sell, and purchasers of our systems can seek to buy, alternative versions of our ink and other consumables or alternative spare parts. We have encountered limited instances of these activities by third parties in specific regions. Third-party ink and other consumables and spare parts might be less expensive or otherwise more appealing to our customers than our ink and other consumables. Significant sales of third-party inks and other consumables and spare parts to our customers could adversely impact our revenues and would have a more significant effect on our gross margins and overall profitability.

Given the sensitivity of our systems and, in particular, print heads to lower quality ink, which may cause our print heads to clog or otherwise malfunction, our systems are setup to operate at the highest throughput level only when using our original ink and other consumables in order to protect them from damage. In addition, since we are unable to control the impact of third-party inks, their use and the use of third-party spare parts might void the warranty that comes with our systems. We have also sought to protect the proprietary technology underlying our ink through patents and other forms of intellectual property protections and include an RFID mechanism with our ink tanks. These steps that we have taken to ensure the smooth operation of our systems and our ability to fully invoke all our intellectual property rights may be challenged. Any reduction in our ability to market and sell our ink and other consumables and spare parts for use in our systems may adversely impact our future revenues and our overall profitability.

***We face increased competition and if we do not compete successfully, our revenues and demand for our solutions could decline.***

The principal competition for our digital printing systems comes from manufacturers of analog screen printing systems, textile printers and ink, such as M&R Printing Equipment, Inc., Machines Highest Mechatronic GmbH and S. Roque – Máquinas e Tecnologia Laser, S.A. Our principal competitor in the high throughput digital direct-to-garment market is Aeoon Technologies GmbH. We also face competition in this market from Brother International Corporation, Seiko Epson Corporation, Ricoh Company Ltd. and a number of smaller competitors with respect to our entry level system. Our competitors in the Direct-to-Fabric (also known as R2R), or DTF, market include: Dover Corporation through its MS Printing Solutions S.r.l. subsidiary; Seiko Epson Corporation through its subsidiary, Fratelli Robustelli S.r.l; Durst Phototechnik AG; Electronics for Imaging, Inc. through its Reggiani Macchine SpA subsidiary; and a number of smaller competitors. Some of our current and potential competitors have larger overall installed bases, longer operating histories and greater name recognition than we have. In addition, many of these competitors have greater sales and marketing resources, more advanced manufacturing operations, broader distribution channels and greater customer support resources than we have. Some of our competitors in the DTF market gained their current market position by merging with, or acquiring, existing companies in the DTF market. Current and future competitors may be able to respond more quickly to changes in customer demands and devote greater resources to the development, promotion and sale of their printers and ink and other consumables than we can.

Our current and potential competitors in both the direct-to-garment and direct-to-fabric markets may also develop and market new technologies that render our existing solutions unmarketable or less competitive. In addition, if these competitors develop products with similar or superior functionality to our solutions at prices comparable to or lower than ours, we may be forced to decrease the prices of our solutions in order to remain competitive, which could reduce our gross margins.

***Our move towards a higher proportion of direct sales in place of indirect sales may have adverse consequences.***

Our go-to-market strategy consists of a hybrid model of indirect and direct sales. We continually evaluate that strategy in the geographies we serve in an effort to best serve our direct or indirect customers. As a result of that evaluation, we have implemented, effective as of February 7, 2019, a full direct-to-customer model in North America, and have terminated, as of that date, our Sales Representative Agreement with Hirsch International Corporation, or Hirsch, our former primary distributor in the United States and Canada, which accounted for 18% and 15% of our revenues in the years ended December 31, 2017 and 2018, respectively. We also purchased related customer business assets from Hirsch at the time of termination of the distribution agreement. We may also expand our implementation of direct sales in place of indirect sales in certain additional territories in the future. As we shift towards such a model, we may experience an initial disruption to our sales efforts in those jurisdictions as we transition from our previous sales structure. In addition, a shift to a direct sales model may result in a short-term impact on our results of operations, including due to the acquisition of inventory that might require a step up in basis and other such accounting impacts and costs associated with increased headcount and related expenses. Moreover, the implementation of a direct sales model may require significant management time and attention which could result in an adverse impact on our business and results of operations during the transition period. There is no assurance that a direct sales approach will increase sales. We may be exposed to risks as a result of transitioning from an indirect sales model to a direct sales model, such as difficulties maintaining relationships with specific customers, hiring appropriately trained personnel and ensuring compliance with local product registration requirements, any of which could result in lower revenues than previously received from the distributors in that market.

***A significant portion of our sales is concentrated among a small number of customers, and our business would be adversely affected by a decline in sales to, or the loss of, those customers.***

During the years ended December 31, 2017 and 2018, our ten largest customers accounted for approximately 55% and 54% of our revenues, respectively. During those same years, Amazon Corporate LLC, a subsidiary of Amazon.com, Inc., which we collectively refer to as Amazon, accounted for approximately 13% and 17% of our revenues, respectively. Given the concentration of our revenues with these customers, the loss of either Amazon or another one of our significant customers, or variability in their order flows, could materially adversely affect our revenues or results of operations.

***Our operating results are subject to seasonal variations, which could cause the price of our ordinary shares to decline.***

Our business is seasonal. Either the third or fourth quarter has historically been our strongest quarter in terms of revenues and the first quarter has been our weakest. This seasonality coincides with spending in anticipation of the holidays towards the end of the year, especially in the United States and Europe. In the last three fiscal years, we have continuously increased our operating expenses throughout the year, and as such, the expense run rate at which we have ended each year is significantly higher than where we started the given year. The carryover of such costs into the first quarter of the following year results in downward pressure on operating margins, which is compounded by seasonally lower revenue in the first quarter compared to other quarters.

In addition, during the third and fourth quarters, when customer spending is at its highest levels, we enjoy a more favorable revenue mix, generating greater revenues from the sales of ink and other consumables than in the first quarter. Since sales of ink and other consumables generate higher gross margins than systems sales, gross margin in the third or fourth quarter tends to be higher than gross margin in the first quarter, when our customers typically reduce their system utilization rates significantly, and thereby purchase less ink and other consumables. This impact leads to a reduction in overall operating margins. As we continue to focus our sales efforts on larger accounts, and as we continue to invest in the growth of our business, the impact of this seasonal decline in revenues generated from sales of ink and other consumables has had and may continue to have a more pronounced impact on gross margins and operating margins.

***Our quarterly results of operations have fluctuated in the past and may fluctuate in the future due to variability in our revenues.***

Our revenues and other results of operations have fluctuated from quarter to quarter in the past and could continue to fluctuate in the future. Our revenues depend in part on the sale and delivery of our systems, and we cannot predict with certainty when sales transactions for our systems will close or when we will be able to recognize the revenues from such sales, which generally occurs upon delivery of our systems. Customers that we expect to purchase our systems may delay doing so due to timing of obtaining regulatory permits or a change in their priorities or business plans, including as a result of adverse general economic conditions that may disproportionately impact the ability of the small businesses that constitute a significant portion of our customer base to expend capital or access financing sources. Such conditions could also force us to reduce our prices or limit our ability to profit from economies of scale, which could harm our gross margins. As a result of these factors, we may fail to meet market expectations for any given quarter if sales that we expect for that quarter are delayed until subsequent quarters. Our Allegro and Vulcan systems are offered at a higher average selling price than our other systems and, as a result, have longer sales cycles. The closing of one or more large transactions in a particular quarter may make it more difficult for us to meet market expectations in subsequent quarters, and our failure to close one or more large transactions in a particular quarter could adversely impact our revenues for that quarter. In addition, we may experience slower growth in our gross margins as our new systems gain commercial acceptance. Our gross margins may also fluctuate based on the regions in which sales of these systems occur.

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Our customers generally purchase our ink and other consumables on an as-needed basis, and delays in making such purchases by a number of customers could result in a meaningful shift of revenues from one quarter to the next. Moreover, because ink and other consumables have a shelf life of up to 12 months, we typically maintain inventories of ink and other consumables sufficient to cover our average sales for one quarter. These inventories may not match customers' demands for any given quarter, which could cause shortages or excesses in our inventory of ink and other consumables and result in fluctuations of our quarterly revenues. To the extent that we have excess inventory of ink and consumables that we are unable to sell due to spoilage or otherwise, we may have to write off such inventory. These inventory requirements may also limit our ability to profit from economies of scale in the production and marketing of our ink and other consumables.

Furthermore, we base our current and future expense levels on our revenue forecasts and operating plans, and our costs are relatively fixed in the short term, due in part to long lead times required for ordering certain components of our systems and ordering assembly of our systems by third-party manufacturers. Accordingly, we would likely not be able to reduce our costs sufficiently to compensate for an unexpected shortfall in revenues during a particular quarter, and even a relatively small decrease in revenues could disproportionately and adversely affect our financial results for that quarter. The variability and unpredictability of these and other factors could result in our failing to meet financial expectations for a given period.

***Our contractual arrangements with Amazon, a significant customer, contain a number of material undertakings by us and other agreements the impact of which cannot be fully predicted in advance.***

In January 2017, we entered into a master purchase agreement with an affiliate of Amazon.com, Inc. governing sales of our systems and ink and other consumables at agreed-upon prices that vary based on sales volumes. We also agreed to provide maintenance services and extended warranties to Amazon at agreed prices. The term of the agreement is five years beginning on May 1, 2016 and extends automatically for additional one-year periods unless terminated by Amazon. According to the agreement we were required to issue to an affiliate of Amazon warrants to purchase up to 2,932,176 of our ordinary shares which vest based on payments made by Amazon in connection with the purchase of goods and services from us.

Our contractual agreements with Amazon contain a number of material undertakings and other arrangements:

Our revenues are presented net of the relative value of the warrants in each particular period related to the revenues recognized. The value of the warrants depends, in part, on the price of our shares and their volatility, and the adverse impact of the warrants on our net revenues increases as our share price increases. Accordingly, our net revenues may fluctuate due to the non-cash impact of the value of the warrant on our gross revenues.

We have agreed to provide a rebate to Amazon based on the number of systems and amount of ink and other consumables Amazon orders in a given 12-month period. The timing and scale of any such rebate may be difficult to predict and may cause fluctuations in our quarterly and annual revenues, gross profit and operating profit.

We are required to notify Amazon 12 months in advance if we intend to stop supporting one of the products or services that we supply to Amazon and to continue to manufacture the product or provide such service during such 12-month period. Subject to certain exceptions, we are required to continue to supply ink in such quantities as Amazon requires for at least 36 months after the earlier of (1) the end of the term of the master purchase agreement or (2) 18 months following the purchase of the last product sold pursuant to the agreement.

We are required to deliver our products and services to Amazon and to comply with a service level agreement. If we fail to meet the requirements under such service level agreement Amazon will receive credits against its cost for those delayed products or services.

The impact of the provisions listed above cannot be fully predicted in advance and could, in certain circumstances, adversely impact our business or results of operations, or the manner in which investors or analysts assess and perceive our performance.

***If our relationships with suppliers, especially with single source suppliers of components, were to terminate, our business could be harmed.***

We maintain an inventory of parts to facilitate the timely assembly of our systems, production of our ink and other consumables, and servicing our installed base. Most components are available from multiple suppliers, although certain components used in our systems and ink and other consumables, such as our print heads and certain chemicals included in our inks, are only available from single or limited sources as described below.

The print heads for our systems are supplied by a sole supplier, FujiFilm Dimatix, Inc., or FDMX. We entered into an agreement with FDMX in 2015, pursuant to which FDMX is continuing to sell us certain off-the-shelf print heads and additional products, all of which FDMX regularly sells to providers of inkjet systems. The agreement provides that beginning with the start of the first one-year renewal period, FDMX may increase the prices of the products that we purchase from it upon 90-days’ prior notice, subject to certain conditions. The agreement renews automatically for successive one-year periods, but FDMX or we can terminate the agreement upon 90 days’ notice prior to the end of the then current term. Our current agreement terminates in December 2019 and provides for one three-year renewal period and for further one-year renewal periods thereafter. Our agreement further provides that FDMX may, at its option, discontinue products supplied under the agreement, provided that we are given one year notice of the planned discontinuance and are provided with an end of life purchase program.

A chemical used in some of our inks is supplied by B.G. (Israel) Technologies Ltd., or BG Bond, a subsidiary of Ashtrom Ltd., a large public Israeli industrial company. We entered into an agreement with BG Bond in December 2016 pursuant to which we agree to purchase and BG Bond agrees to produce this chemical at set prices. In exchange for an upfront payment, which is refundable upon the purchase of the chemical, BG Bond agreed to install additional equipment dedicated to the production of the chemical. The agreement is for a term of five years or until we purchase a certain agreed upon minimum quantity and cannot be terminated by us other than in case of material breach by BG Bond. For some of our inks, this chemical is supplied by The Dow Chemical Company, a multinational producer of chemicals and other compounds. We currently purchase these chemicals from the Dow Chemical Company on a purchase order basis.

Certain parts of the control system of our systems are supplied by a sole supplier, Yaskawa Europe Technology Ltd., or Yaskawa. Our turn key suppliers (Flex and Sanmina), which assemble the control system on our behalf, purchase those control system parts from Yaskawa. We also purchase additional, spare control system parts from Yaskawa for our service department on a purchase order basis. Yaskawa maintains additional inventory of these control system parts as safety stock for our benefit, based on our requirements.

The loss of any of these suppliers, or of a supplier for which there are limited other sources, could result in the delay of the manufacture and delivery of our systems or inks and other consumables. For instance, FDMX has from time to time indicated that it may discontinue manufacturing the print head that we currently source from it and use in our systems, although it has never provided notice that it is actually doing so. In the event FDMX discontinues manufacturing the print head, we would be required to qualify a new print head for our systems. In order to minimize the risk of any impact from a disruption or discontinuation in the supply of print heads, raw materials or other components from limited source suppliers, we maintain an additional inventory of such components, in addition to the end of life purchase program that would be available to us if the products we purchase from FDMX were discontinued. Nevertheless, such inventory may not be sufficient to enable us to continue supplying our products should we need to locate and qualify a new supplier.

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Other risks stemming from our reliance on suppliers include:

- if we experience an increase in demand for our solutions, our suppliers may be unable to provide us with the components that we need in order to meet that increased demand in a timely manner;
- our suppliers may encounter financial hardships unrelated to our demand for components, which could inhibit their ability to fulfill our orders and meet our requirements;
- we may experience production delays related to the evaluation and testing of products from alternative suppliers;
- we may be subject to price fluctuations due to a lack of long-term supply arrangements for key components;
- we or our suppliers may lose access to critical services and components, resulting in an interruption in the manufacture, assembly and shipment of our systems or inks and other consumables; and
- fluctuations in demand for components that our suppliers manufacture for others may affect their ability or willingness to deliver components to us in a timely manner.

If any of these risks materialize, the costs associated with developing alternative sources of supply or assembly in a timely manner could have a material adverse effect on our ability to meet demand for our solutions. Our ability to generate revenues could be impaired, market acceptance of our solutions could be adversely affected, and customers may instead purchase or use alternative products. We may not be able to find new or alternative components of a requisite quality or find that we are unable to reconfigure our systems and manufacturing processes in a timely manner if the necessary components become unavailable. As a result, we could incur increased production costs, experience delays in the delivery of our solutions and suffer harm to our reputation, which may have an adverse effect on our business and results of operations.

***Our new Kiryat Gat facility is being constructed on lands leased by the Company from the Israel Lands Administration, or ILA. If we are unable to continue to use such lands, we would be unable to use the facility and our results of operations and future prospects will suffer as a result.***

In November 2018, we entered into a development agreement, which we refer to as the Development Agreement, with the ILA for the construction of our new, modern, manufacturing facility in Kiryat Gat on lands leased from the ILA. Construction has begun and is currently expected to be completed by 2020. The Development Agreement provides

that if the Company were a "foreign subject," which includes the Company being under foreign control (i.e., a majority of our ordinary shares are held by non-Israelis), this would constitute a fundamental breach under the agreement. We intend to follow a specific standard process for seeking approval from the ILA in which the ILA approves our entering into the Development Agreement despite our potential status as a "foreign subject," since our shares are traded on NASDAQ, and we are held by multiple shareholders whose identities are unknown. However, should such approval not be provided, the ILA would be entitled to terminate the Development Agreement if the Company is considered a "foreign subject" under the terms of such agreement. If the Development Agreement were terminated, we would be unable to use the new Kiryat Gat facility being constructed on this property pursuant to the Development Agreement, which would have a material adverse effect on our results of operations.

***Disruption of operations at our manufacturing site or those of third-party manufacturers could prevent us from filling customer orders on a timely basis.***

We manufacture our ink and other consumables at our facility in Kiryat Gat, Israel (which we are in the process of replacing with a new, modern facility being constructed). We also rely on contract manufacturing services provided by Flex Israel Ltd. and Sanmina-SCI Israel Medical Systems Ltd., which are also in Israel, to assemble our systems. We expect that almost all of our revenues in the near term will be derived from the systems and ink and other consumables manufactured at these facilities.

The loss of any of these contract manufacturers could result in the delay of the assembly and delivery of our systems. If that occurs or these contract manufacturers cease to provide manufacturing services for any reason, the costs associated with developing alternative sources of assembly in a timely manner could have a material adverse effect on our ability to meet demand for our solutions. Our ability to generate revenues could be impaired, market acceptance of our solutions could be adversely affected, and customers may instead purchase or use alternative products.

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If operations in any of these facilities were to be disrupted due to a major equipment failure or power failure lasting beyond the capabilities of backup generators or other events outside of our reasonable control, our manufacturing capacity could be shut down for an extended period, we could experience a loss of raw materials or finished goods inventory and our ability to operate our business would be harmed. In addition, in any such event, the repair or reconstruction of our or our third-party manufacturers' manufacturing facilities and storage facilities could take a significant amount of time. During this period, we or our third-party manufacturers would be unable to manufacture some or all of our systems or we may not be able to produce our ink and other consumables. In addition, at any given moment we have only a limited inventory of our systems and ink and other consumables that we can supply to our customers in the event that our manufacturing is disrupted.

***Our operating results could decline in the near-term if we fail to execute on our growth strategies.***

Our operating margin was 3.9% in 2018 and 1.3% in 2016, and we had an operating loss of 1.8% in 2017. Our growth strategies, many of which are aimed at achieving operating and net profit margins, include increasing sales to existing customers, acquiring new high volume customers, capitalizing on growth in our targeted markets and extending our serviceable addressable market by continuing to enhance our solutions. If we do not execute these strategies successfully, it could adversely impact our revenues and have a negative impact on our operating and net profit margins.

***Our business and operations may be negatively affected if we fail to effectively manage our growth.***

We have experienced significant growth in a relatively short period of time and intend to continue to grow our business. Our revenues grew from $66.4 million in 2014 to $142.4 million in 2018. Our headcount increased from 251 as of December 31, 2014 to 444 as of December 31, 2018. We plan to hire additional employees across all areas of our company. Our rapid growth has placed significant demands on our management, sales and operational and financial infrastructure, and our growth will continue to place significant demands on these resources. Further, in order to manage our future growth effectively, we must continue to improve our IT and financial infrastructure, operating and administrative systems and controls and efficiently manage headcount, capital and processes. We may not be able to successfully implement these improvements in a timely or efficient manner, and our failure to do so may materially impact our projected growth rate.

***Significant disruptions of our information technology systems or breaches of our data security could adversely affect our business.***

A significant invasion, interruption, destruction or breakdown of our information technology, or IT, systems and/or infrastructure by persons with authorized or unauthorized access could negatively impact our business and operations. We could also experience business interruption, information theft and/or reputational damage from cyber attacks, which may compromise our systems and lead to data leakage either internally or at our third party suppliers or customers. Both data that has been inputted into our main IT platform, which covers records of transactions, financial data and other data reflected in our results of operations, as well as data related to our proprietary rights (such as research and development, and other intellectual property- related data), are subject to material cyber security risks. Our IT systems have been, and are expected to continue to be, the target of malware and other cyber attacks. To date, we are not aware that we have experienced any loss of, or disruption to, material information as a result of any such malware or cyber attack.

We have invested in advanced protective systems to reduce these risks, some of which have been installed and others that are still in the process of installation. Based on information provided to us by the suppliers of our protective systems, we believe that our level of protection is in keeping with the customary practices of peer technology companies. We also maintain back-up files for much of our information, as a means of assuring that a breach or cyber attack does not necessarily cause the loss of that information. We furthermore review our protections and remedial measures periodically in order to ensure that they are adequate.

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Despite these protective systems and remedial measures, techniques used to obtain unauthorized access are constantly changing, are becoming increasingly more sophisticated and often are not recognized until after an exploitation of information has occurred. We may be unable to anticipate these techniques or implement sufficient preventative measures, and we therefore cannot assure you that our preventative measures will be successful in preventing compromise and/or disruption of our information technology systems and related data. We furthermore cannot be certain that our remedial measures will fully mitigate the adverse financial consequences of any cyber attack or incident.

***We and our customers are subject to extensive environmental, health and safety laws and regulations which, if not met, could have a material adverse effect on our business, financial condition and results of operations.***

Our manufacturing and development facilities use chemicals and produce waste materials, which require us to hold business licenses that may include conditions set by the Ministry of Environmental Protection for the operations of such facilities. We are also subject to extensive environmental, health and safety laws and regulations governing, among other things, the use, storage, registration, handling and disposal of chemicals and waste materials, the presence of specified substances in electrical products, air, water and ground contamination, air emissions and the cleanup of contaminated sites. In the future we may incur expenditure of significant amounts in the event of non-compliance and/or remediation. Furthermore, requirements of environmental laws have adversely affected and may continue to adversely affect the ability of our customers to install and use our systems in a timely manner. If we fail to comply with such laws or regulations, we may be subject to fines and other civil, administrative or criminal sanctions, including the revocation of our toxin permit, business permits, or other permits and licenses necessary to continue our business activities. In addition, we may be required to pay damages or civil judgments in respect of third-party claims, including those relating to personal injury, including exposure to hazardous substances that we use, store, handle, transport, manufacture or dispose of, or property damage. Some environmental, health and safety laws and regulations allow for strict, joint and several liability for remediation costs, regardless of comparative fault. We may be identified as a potentially responsible party under such laws. In addition, our customers may encounter delays in obtaining or be unable to obtain regulatory permits to operate our systems in their facilities, which may result in cancellation or delay of orders of our systems.

The export of our products internationally subjects us to environmental laws and regulations concerning the import and export of chemicals and hazardous substances. In the European marketplace, electrical and electronic equipment is required to comply with the Directive on Waste Electrical and Electronic Equipment, or WEEE, which aims to prevent waste by encouraging reuse and recycling, and the Directive on Restriction of Use of Certain Hazardous Substances, or RoHS, which restricts the use of ten hazardous substances in electrical and electronic products. Additionally, we are required to comply with certain laws, regulations and directives such as the United States Toxic Substances Control Act, or TSCA, and the Registration, Evaluation, Authorization and Restriction of Chemical Substances, or REACH. These laws and regulations require the testing and registration of some chemicals that we ship along with, or that form a part of, our systems and other products. If we fail to comply with these or similar laws and regulations, we may be required to make significant expenditures to reformulate the chemicals that we use in our products and materials or incur costs to register such chemicals to gain and/or regain compliance. Additionally, we could be subject to significant fines or other civil and criminal penalties should we not achieve such compliance.

Any of such developments could have a material adverse effect on our business, financial condition and results of operations. Environmental, health and safety laws and regulations may also change from time to time. Complying with any new requirements may involve substantial costs and could cause significant disruptions to our research, development, manufacturing, and sales.

***Exchange rate fluctuations between the U.S. dollar and the Israeli shekel, the Euro and other non-U.S. currencies may negatively affect our earnings.***

The dollar is our functional and reporting currency. However, a significant portion of our operating expenses are incurred in Israeli shekels, or NIS. As a result, we are exposed to the risk that the NIS may appreciate relative to the dollar, or, if the NIS instead devalues relative to the dollar, that the inflation rate in Israel may exceed such rate of devaluation of the NIS, or that the timing of such devaluation may lag behind inflation in Israel. In any such event, the dollar cost of our operations in Israel would increase and our dollar-denominated results of operations would be adversely affected. To protect against an increase the dollar-denominated value of expenses paid in NIS during the year, we have instituted a foreign currency cash flow hedging program, which seeks to hedge a portion of the economic exposure associated with our anticipated NIS-denominated expenses using derivative instruments. We expect that the substantial majority of our revenues will continue to be denominated in U.S. dollars for the foreseeable future and that a significant portion of our expenses will continue to be denominated in NIS. We cannot provide any assurances that our hedging activities will be successful in protecting us in full from adverse impacts from currency exchange rate fluctuations since we only plan to hedge a portion of our foreign currency exposure, and we cannot predict any future trends in the rate of inflation in Israel or the rate of devaluation (if any) of the NIS against the dollar For example, based on annual average exchange rates, the dollar depreciated by 1.1%, 6.3% and 0.1% against the NIS in 2016, 2017 and 2018, respectively. During these periods, there was deflation in Israel of 0.2% in 2016, and inflation of 0.4% and 0.8% in 2017 and 2018, respectively. If the dollar cost of our operations increases, our dollar-measured results of operations will be adversely affected. See "ITEM 11. Quantitative and Qualitative Disclosures about Market Risk—Foreign Currency Risk."

In addition, a material portion of our leases are denominated in currencies other than the U.S. dollar, mainly in NIS. In accordance with a new lease accounting standard, which became effective on January 1, 2019, the associated lease liabilities will be remeasured using the current exchange rate in future reporting periods, which may result in material foreign exchange gains or losses. See Note 2, "Significant Accounting Policies", to the consolidated financial statements included in Item 18 of this annual report for more details.

***Our business could suffer if we are unable to attract and retain key employees.***

Our success depends upon the continued service and performance of our senior management and other key personnel. Our senior executive team is critical to the management of our business and operations, as well as to the development of our strategies. The loss of the services of any of these personnel could delay or prevent the continued successful implementation of our growth strategy, or our commercialization of new applications for our systems and ink and other consumables, or could otherwise affect our ability to manage our company effectively and to carry out our business plan. Members of our senior management team may resign at any time. High demand exists for senior management and other key personnel in our industry. There can be no assurance that we will be able to continue to retain such personnel. Effective August 1, 2018, Gabi Seligsohn stepped down after four years as our Chief Executive Officer, and was succeeded by Ronen Samuel. In addition, Nuriel Amir, our Chief Technology Officer since July 1,

2016, will no longer serve in that role at our company, effective as of April 1, 2019. To the extent that we experience additional, frequent changes in our leadership team (or the leadership teams of our subsidiaries) going forward, that could adversely affect our performance in a material manner.

Our growth and success also depend on our ability to attract and retain additional highly qualified scientific, technical, sales, managerial, operational, HR, marketing and finance personnel. We compete to attract qualified personnel, and, in some jurisdictions in which we operate, the existence of non-competition agreements between prospective employees and their former employers may prevent us from hiring those individuals or subject us to lawsuits from their former employers. While we attempt to provide competitive compensation packages to attract and retain key personnel, some of our competitors have greater resources and more experience than we have, making it difficult for us to compete successfully for key personnel. If we cannot attract and retain sufficiently qualified technical employees for our research and development operations on acceptable terms, we may not be able to continue to competitively develop and commercialize our solutions or new applications for our existing systems. Further, any failure to effectively integrate new personnel could prevent us from successfully growing our company.

***Under applicable employment laws, we may not be able to enforce covenants not to compete and therefore may be unable to prevent our competitors from benefiting from the expertise of some of our former employees.***

We generally enter into non-competition agreements with our employees. These agreements prohibit our employees, if they cease working for us, from competing directly with us or working for our competitors or clients for a limited period. We may be unable to enforce these agreements under the laws of the jurisdictions in which our employees work and it may be difficult for us to restrict our competitors from benefiting from the expertise that our former employees or consultants developed while working for us. For example, Israeli labor courts have required employers seeking to enforce non-compete undertakings of a former employee to demonstrate that the competitive activities of the former employee will harm one of a limited number of material interests of the employer that have been recognized by the courts, such as the secrecy of a company's trade secrets or other intellectual property.

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***We have a significant presence in international markets and plan to continue to expand our international operations, which exposes us to a number of risks that could affect our future growth.***

We have a worldwide sales, marketing and support infrastructure that is comprised of independent distributors and value added resellers, and our own personnel resulting in a sales, marketing and support presence in over 100 countries, including markets in North America, Western and Eastern Europe, the Asia Pacific region and Latin America. We expect to continue to increase our sales headcount, our applications development headcount, our field support headcount, our marketing headcount and our engineering headcount and, in some cases, establish new relationships with distributors, particularly in markets where we currently do not have a sales or customer support presence. As we continue to expand our international sales and operations, we are subject to a number of risks, including the following:

- greater difficulty in enforcing contracts and accounts receivable collection, as well as longer collection periods;
- increased expenses incurred in establishing and maintaining office space and equipment for our international operations;
- fluctuations in exchange rates between the U.S. dollar and foreign currencies in markets where we do business;
- greater difficulty in recruiting local experienced personnel, and the costs and expenses associated with such activities;
- general economic and political conditions in these foreign markets;
- economic uncertainty around the world;
- management communication and integration problems resulting from cultural and geographic dispersion;
- risks associated with trade restrictions and foreign legal requirements, including the importation, certification, and localization of our solutions required in foreign countries, such as high import taxes in Brazil and other Latin American markets where we sell our products;
- greater risk of unexpected changes in regulatory practices, tariffs, and tax laws and treaties;

- the uncertainty of protection for intellectual property rights in some countries;

- greater risk of a failure of employees to comply with both U.S. and foreign laws, including antitrust regulations, the U.S. Foreign Corrupt Practices Act, or FCPA, the new European Union General Data Protection Regulation, or GDPR (which broadens the scope of personal privacy laws to protect the rights of European Union citizens and requires organizations to report on data breaches promptly and obtain the consent of individuals on how their data can be used), and any trade regulations ensuring fair trade practices; and

- heightened risk of unfair or corrupt business practices in certain regions and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of, or irregularities in, financial statements.

Any of these risks could adversely affect our international operations, reduce our revenues from outside the United States or increase our operating costs, adversely affecting our business, results of operations and financial condition and growth prospects. There can be no assurance that all of our employees and channel partners will comply with the formal policies that we have in place and/or will implement, or applicable laws and regulations. Violations of laws or key control policies by our employees and channel partners could result in delays in revenue recognition, financial reporting misstatements, fines, penalties or the prohibition of the importation or exportation of our software and services and could have a material adverse effect on our business and results of operations.

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***If we are unable to obtain patent protection for our solutions or otherwise protect our intellectual property rights, our business could suffer.***

The success of our business depends on our ability to protect our proprietary technology, brand owners and other intellectual property and to enforce our rights in that intellectual property. We attempt to protect our intellectual property under patent, trademark, copyright and trade secret laws, and through a combination of confidentiality procedures, contractual provisions and other methods, all of which offer only limited protection.

As of December 31, 2018, we owned seventeen (17) issued patents in the United States and nineteen (19) provisional or pending U.S. patent applications, along with thirty one (31) pending non-U.S. patent applications. We also had twelve (12) patents issued in non-U.S. jurisdictions, and eleven (11) pending Patent Cooperation Treaty patent applications, which are counterparts of our U.S. patent applications. The non-U.S. jurisdictions in which we have issued patents or pending applications are China, the European Union or European countries of the European Union, Hong Kong, Israel, Canada, Australia, Republic of Korea, South Africa, Vietnam, Philippines, Thailand, Brazil, El Salvador, Dominican Republic, Japan and India. We may file additional patent applications in the future. The process of obtaining patent protection is expensive, time-consuming, and uncertain, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner all the way through to the successful issuance of a patent. We may choose not to seek patent protection for certain innovations and may choose not to pursue patent protection in certain jurisdictions. Furthermore, it is possible that our patent applications may not issue as granted patents, that the scope of our issued patents will be insufficient or not have the coverage originally sought, that our issued patents will not provide us with any competitive advantages, and that our patents and other intellectual property rights may be challenged by others through administrative processes or litigation resulting in patent claims being narrowed, invalidated, or unenforceable. In addition, issuance of a patent does not guarantee that we have an absolute right to practice the patented invention. Our policy is to require our employees (and our consultants and service providers, including third-party manufacturers of our systems and components, that develop intellectual property included in our systems) to execute written agreements in which they assign to us their rights in potential inventions and other intellectual property created within the scope of their employment (or, with respect to consultants and service providers, their engagement to develop such intellectual property), but we cannot assure you that we have adequately protected our rights in every such agreement or that we have executed an agreement with every such party. Finally, in order to benefit from the protection of patents and other intellectual property rights, we must monitor and detect infringement and pursue infringement claims in certain circumstances in relevant jurisdictions, all of which are costly and time-consuming. As a result, we may not be able to obtain adequate protection or to effectively enforce our issued patents or other intellectual property rights.

In addition to patents, we rely on trade secret rights, copyrights, trademarks, and other rights to protect our proprietary intellectual property and technology. Despite our efforts to protect our proprietary intellectual property and technology, unauthorized parties, including our employees, consultants, service providers or customers, may attempt to copy aspects of our solutions or obtain and use our trade secrets or other confidential information. We generally enter into confidentiality agreements with our employees, consultants, service providers, vendors, channel partners and customers, and generally limit access to and distribution of our proprietary information and proprietary technology through certain procedural safeguards. These agreements may not effectively prevent unauthorized use or

disclosure of our intellectual property or technology and may not provide an adequate remedy in the event of unauthorized use or disclosure of our intellectual property or technology. We cannot assure you that the steps taken by us will prevent misappropriation of our intellectual property or technology or infringement of our intellectual property rights. In addition, the laws of some foreign countries where we sell or distribute our solutions do not protect intellectual property rights and technology to the same extent as the laws of the United States, and these countries may not enforce these laws as diligently as government agencies and private parties in the United States. Based on the 2017 report on intellectual property rights protection and enforcement published by the Office of the United States Trade Representative, such countries included Argentina, Chile, China, India, Indonesia, Russia, Thailand and Ukraine (designated as priority watch list countries).

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***If we are unable to protect our trademarks from infringement, our business prospects may be harmed.***

We own trademarks that identify “Kornit” “NeoPigment” and the “K” logo among others, and have registered these trademarks in certain key markets. Although we take steps to monitor the possible infringement or misuse of our trademarks, third parties may violate our trademark rights. In addition, we may not have trademark rights in all of the markets in which we may sell our products. Any unauthorized use of our trademarks could harm our reputation or commercial interests. In addition, efforts to enforce our trademarks may be expensive and time-consuming, and may not effectively prevent infringement.

In September 2016, we filed an application with the European Union Intellectual Property Office (“EUIPO”) to register the “Kornit” trademark in the European Union. In October 2016, Grupo FB Maquinaria, S.A. (“Grupo”) filed an opposition to our application on the premise that it was identical to an earlier mark, and covered identical goods and/or services, as Grupo’s “Kornit” trademark. Grupo had filed an application to register its “Kornit” trademark in January 2016. We believe that the opposition is meritless and filed an application with EUIPO in July 2017 to declare the Grupo’s registration of the “Kornit” trademark invalid on the basis that the registration was done in bad faith. We are awaiting a ruling by the EUIPO and there can be no assurance that we will prevail. If the EUIPO denies our application to register the “Kornit” trademark, we could be forced to stop using the trademark in the European Union or enter into a license agreement with Grupo to use the mark, which could adversely impact our brand recognition in the European Union and our results of operations.

***We may become subject to claims of intellectual property infringement by third parties or may be required to indemnify our distributors or other third parties against such claims, which, regardless of their merit, could result in litigation, distract our management and materially adversely affect our business, results of operations or financial condition.***

We have in the past and may in the future become subject to third-party claims that assert that our solutions, services and intellectual property infringe, misappropriate or otherwise violate third-party intellectual property or other proprietary rights.

Intellectual property disputes can be costly and disruptive to our business operations by diverting the attention and energies of management and key technical personnel, and by increasing our costs of doing business. Even if a claim is not directly against us, our agreements with distributors generally require us to indemnify them against losses from claims that our products infringe third-party intellectual property rights and entitle us to assume the defense of any claim as part of the indemnification undertaking. Our assumption of the defense of such a claim may result in similar costs, disruption and diversion of management attention to that of a claim that is asserted directly against us. We may not prevail in any such dispute or litigation, and an adverse decision in any legal action involving intellectual property rights could harm our intellectual property rights and the value of any related technology or limit our ability to execute

our business.

Adverse outcomes in intellectual property disputes could:

- require us to redesign our technology or force us to enter into costly settlement or license agreements on terms that are unfavorable to us;
- prevent us from manufacturing, importing, using, or selling some or all of our solutions;
- disrupt our operations or the markets in which we compete;
- impose costly damage awards;
- require us to indemnify our distributors and customers; and
- require us to pay royalties.

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***We may become subject to claims for remuneration or royalties for assigned service invention rights by our employees, which could result in litigation and adversely affect our business.***

A significant portion of our intellectual property has been developed by our employees in the course of their employment for us. Under the Israeli Patent Law, 5727-1967, or the Patent Law, inventions conceived by an employee in the course and as a result of or arising from his or her employment with a company are regarded as "service inventions," which belong to the employer, absent a specific agreement between the employee and employer giving the employee proprietary rights. The Patent Law also provides under Section 134 that if there is no agreement between an employer and an employee as to whether the employee is entitled to consideration for service inventions, and to what extent and under which conditions, the Israeli Compensation and Royalties Committee, or the Committee, a body constituted under the Patent Law, shall determine these issues. Section 135 of the Patent law provides criteria for assisting the Committee in making its decisions. According to case law handed down by the Committee, an employee's right to receive consideration for service inventions is a personal right and is entirely separate from the proprietary rights in such invention. Therefore, this right must be explicitly waived by the employee. A decision handed down in May 2014 by the Committee clarifies that the right to receive consideration under Section 134 can be waived and that such waiver can be made orally, in writing or by behavior like any other contract. The Committee will examine, on a case by case basis, the general contractual framework between the parties, using interpretation rules of the general Israeli contract laws. Further, the Committee has not yet determined one specific formula for calculating this remuneration, nor the criteria or circumstances under which an employee's waiver of his right to remuneration will be disregarded. Similarly, it remains unclear whether waivers by employees in their employment agreements of the alleged right to receive consideration for service inventions should be declared as void being a depriving provision in a standard contract. We generally enter into assignment-of-invention agreements with our employees pursuant to which such individuals assign to us all rights to any inventions created in the scope of their employment or engagement with us. Although our employees have agreed to assign to us service invention rights and have specifically waived their right to receive any special remuneration for such service inventions beyond their regular salary and benefits, we may face claims demanding remuneration in consideration for assigned inventions.

***Undetected defects in the design or manufacturing of our products may harm our business and results of operations.***

Our systems, ink and other consumables, and associated software may contain undetected errors or defects when first introduced or as new versions are released. We have experienced these errors or defects in the past during the introduction of new systems and system upgrades. We expect that these errors or defects will be found from time to time in new or enhanced systems after commencement of commercial distribution or upon software upgrades. These problems may cause us to incur significant warranty and repair costs, divert the attention of our engineers from our product development and customer service efforts and harm our reputation. We may experience a delay in revenue recognition or collection of due payments from relevant customers as a result of our systems' inability to meet agreed performance metrics. In addition, the use of third-party inks may harm the operation of our systems and reduce customer satisfaction with them, which could harm our reputation and adversely affect sales of our systems. We may also be subject to liability claims for damages related to system errors or defects. Although we carry insurance policies covering this type of liability, these policies may not provide sufficient protection should a claim be asserted against

us. Any product liability claim brought against us could force us to incur significant expenses, divert management time and attention, and harm our reputation and business. In addition, costs or payments made in connection with warranty and product liability claims and system recalls could materially affect our financial condition and results of operations.

***We may need substantial additional capital in the future, which may cause dilution to our existing shareholders, restrict our operations or require us to relinquish rights to our pipeline products or intellectual property. If additional capital is not available, we may have to delay, reduce or cease operations.***

Based on our current business plan, we believe our cash flows from operating activities and our existing cash resources will be sufficient to meet our currently anticipated cash requirements through the next 12 months without drawing on our lines of credit or using significant amounts of the net proceeds from our initial public offering and follow-on offering. Nevertheless, to the extent our anticipated cash requirements change, we may seek additional funding in the future. This funding may consist of equity offerings, debt financings or any other means to expand our sales and marketing capabilities, develop our future solutions or pursue other general corporate purposes. Securing additional financing may divert our management from our day-to-day activities, which may adversely affect our ability to market our current solutions and develop and sell future solutions. Additional funding may not be available to us on acceptable terms, or at all.

To the extent that we raise additional capital through, for example, the sale of equity or convertible debt securities, your ownership interest will be diluted, and the terms may include liquidation or other preferences that adversely affect your rights as a shareholder. The incurrence of indebtedness or the issuance of certain equity securities could result in increased fixed payment obligations and could also result in certain restrictive covenants, such as limitations on our ability to incur additional debt, limitations on our ability to acquire or license intellectual property rights and other operating restrictions that could adversely impact our ability to conduct our business. In addition, the issuance of additional equity securities by us, or the possibility of such issuance, may cause the market price of our ordinary shares to decline.

***We have acquired businesses and may acquire other businesses and/or companies, which could require significant management attention, disrupt our business, dilute shareholder value, and adversely affect our results of operations.***

As part of our business strategy and in order to remain competitive, we have acquired businesses and may acquire or make investments in other complementary companies, products or technologies. However, we have only made small acquisitions and our experience in acquiring and integrating other companies, products or technologies is limited. We may not be able to find suitable acquisition candidates, and we may not be able to complete such acquisitions on favorable terms, if at all. If we complete other acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, and any acquisitions we complete could be viewed negatively by our customers, analysts and investors. In addition, if we are unsuccessful at integrating such acquisitions or the technologies associated with such acquisitions, our revenues and results of operations may be adversely affected. Any integration process may require significant time and resources, and we may not be able to manage the process successfully. We may not successfully evaluate or utilize the acquired technology or personnel, or accurately forecast the financial impact of an acquisition transaction, including accounting charges. We may have to pay cash, incur debt or issue equity securities to pay for any such acquisition, each of which could adversely affect our financial condition or the value of our ordinary shares. The sale of equity or issuance of debt to finance any such acquisitions could result in dilution to our shareholders. The incurrence of indebtedness would result in increased fixed obligations and could also include covenants or other restrictions that would impede our ability to manage our operations.

***We may be subject to additional tax liabilities in the future as a result of audits of our tax returns.***

We are subject to income taxes principally in Israel and the United States. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. We recognize income taxes under the liability method. Tax benefits are recognized from uncertain tax positions only if we believe that it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. We are currently subject to a tax audit for the years 2013 to 2016 by the Israeli Tax Authority, or ITA. The ITA may disagree with our positions taken in our tax returns for these years and we may be subject to additional tax liabilities, which could have a material adverse effect on our results of operations.

**Risks Related to Our Ordinary Shares**

***Our share price may be volatile.***

Our ordinary shares were first offered publicly in our initial public offering in April 2015 at a price of $10.00 per share, and our ordinary shares have subsequently traded as high as $23.90 and as low as $8.10 through March 15, 2019. The market price of our ordinary shares could be highly volatile and may fluctuate substantially as a result of many factors, including:

- actual or anticipated variations in our and/or our competitors' results of operations and financial condition;
- variance in our financial performance from the expectations of market analysts;
- announcements by us or our competitors of significant business developments, changes in service provider relationships, acquisitions, strategic relationships or expansion plans;
- changes in the prices of our solutions;

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- our involvement in litigation;
- our sale of ordinary shares or other securities in the future;
- market conditions in our industry;
- changes in key personnel;
- the trading volume of our ordinary shares;
- changes in the estimation of the future size and growth rate of our markets; and
- general economic and market conditions;

In addition, the stock markets have experienced extreme price and volume fluctuations. Broad market and industry factors may materially harm the market price of our ordinary shares, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against that company. If we were involved in any similar litigation we could incur substantial costs and our management's attention and resources could be diverted. Furthermore, share price volatility may impact the fair value of the warrants granted to Amazon and as a result may impact revenues and profits.

***We have never paid cash dividends on our share capital, and we do not anticipate paying any cash dividends in the foreseeable future.***

We have never declared or paid cash dividends on our share capital, nor do we anticipate paying any cash dividends on our share capital in the foreseeable future. We currently intend to retain all available funds and any future earnings to fund the development and growth of our business. As a result, capital appreciation, if any, of our ordinary shares will be investors' sole source of gain for the foreseeable future. In addition, Israeli law limits our ability to declare and pay dividends, and may subject our dividends to Israeli withholding taxes. Furthermore, our payment of dividends (out of tax-exempt income) may retroactively subject us to certain Israeli corporate income taxes, to which we would not otherwise be subject.

***As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we may follow certain home country corporate governance practices instead of otherwise applicable SEC and NASDAQ requirements,***

***which may result in less protection than is accorded to investors under rules applicable to domestic U.S. issuers.***

As a foreign private issuer whose shares are listed on the NASDAQ Global Select Market, we are permitted to follow certain home country corporate governance practices instead of those otherwise required under the corporate governance standards for U.S. domestic issuers. We currently follow Israeli home country practices with regard to the (i) quorum requirement for shareholder meetings, (ii) independent director oversight requirement for director nominations and (iii) independence requirement for the board of directors. See "ITEM 16G. Corporate Governance." Furthermore, we may in the future elect to follow Israeli home country practices with regard to other matters such as separate executive sessions of independent directors or to obtain shareholder approval for certain dilutive events (such as for the establishment or amendment of certain equity-based compensation plans, issuances that will result in a change of control of the company, certain transactions other than a public offering involving issuances of a 20% or more interest in the company and certain acquisitions of the stock or assets of another company). Accordingly, our shareholders may not be afforded the same protection as provided under NASDAQ corporate governance rules. Following our home country governance practices as opposed to the requirements that would otherwise apply to a United States company listed on NASDAQ may provide less protection than is accorded to investors of domestic issuers. See "ITEM 16G. Corporate Governance."

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***As a foreign private issuer, we are not subject to the provisions of Regulation FD or U.S. proxy rules and are exempt from filing certain Exchange Act reports.***

As a foreign private issuer, we are exempt from a number of requirements under U.S. securities laws that apply to public companies that are not foreign private issuers. In particular, we are exempt from the rules and regulations under the Exchange Act related to the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required under the Exchange Act to file annual and current reports and financial statements with the SEC as frequently or as promptly as U.S. domestic companies whose securities are registered under the Exchange Act and we are generally exempt from filing quarterly reports with the SEC under the Exchange Act. We are also exempt from the provisions of Regulation FD, which prohibits issuers from making selective disclosure of material nonpublic information to, among others, broker-dealers and holders of a company's securities under circumstances in which it is reasonably foreseeable that the holder will trade in the company's securities on the basis of the information. These exemptions and leniencies will reduce the frequency and scope of information and protections to which you are entitled as an investor.

We are not required to comply with the proxy rules applicable to U.S. domestic companies, including the requirement applicable to emerging growth companies to disclose the compensation of our Chief Executive Officer and other two most highly compensated executive officers on an individual, rather than on an aggregate, basis. Nevertheless, the Companies Law requires us to disclose in the notice of convening an annual general meeting the annual compensation of our five most highly compensated office holders on an individual basis, rather than on an aggregate basis, as was previously permitted for Israeli public companies listed overseas. This disclosure is not as extensive as that required of a U.S. domestic issuer.

We would lose our foreign private issuer status if a majority of our directors or executive officers are U.S. citizens or residents and we fail to meet additional requirements necessary to avoid loss of foreign private issuer status. Although we have elected to comply with certain U.S. regulatory provisions, our loss of foreign private issuer status would make such provisions mandatory. The regulatory and compliance costs to us under U.S. securities laws as a U.S. domestic issuer may be significantly higher. If we are not a foreign private issuer, we will be required to file periodic reports and registration statements on U.S. domestic issuer forms with the SEC, which are more detailed and extensive than the forms available to a foreign private issuer. We would also be required to follow U.S. proxy disclosure requirements, including the requirement to disclose more detailed information about the compensation of our senior executive officers on an individual basis. We may also be required to modify certain of our policies to comply with good governance practices associated with U.S. domestic issuers. Such conversion and modifications will involve additional costs. In addition, we would lose our ability to rely upon exemptions from certain corporate governance requirements on U.S. stock exchanges that are available to foreign private issuers.

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***We are an "emerging growth company" and the reduced disclosure requirements applicable to emerging growth companies may make our ordinary shares less attractive to investors.***

We are an "emerging growth company," as defined in the Jumpstart Our Business Startups Act of 2012 effective on April 5, 2012, or the JOBS Act, and we may take advantage of certain exemptions from various requirements that are applicable to other public companies that are not emerging growth companies. Most of such requirements relate to disclosures that we would only be required to make if we cease to be a foreign private issuer in the future. Nevertheless, as a foreign private issuer that is an emerging growth company, we are not required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act for up to five fiscal years after April 2, 2015, the date of our initial public offering. We will remain an emerging growth company until the earliest of: (a) the last day of our fiscal year during which we have total annual gross revenues of at least $1.0 billion; (b) the last day of our fiscal year following the fifth anniversary of the completion of our initial public offering; (c) the date on which we have, during the previous three-year period, issued more than $1.0 billion in non-convertible debt; or (d) the date on which we are deemed to be a "large accelerated filer" under the Exchange Act. We may lose the status of an emerging growth company as of the end of 2019 as a result of the enhanced market value of our shares held by public shareholders following Fortissimo's sale of its shares in our company, which may make us a "large accelerated filer" as of that time. When we are no longer deemed to be an emerging growth company, we will not be entitled to the exemptions provided in the JOBS Act discussed above. We cannot predict if investors will find our ordinary shares less attractive as a result of our reliance on exemptions under the JOBS Act. If some investors find our ordinary shares less attractive as a result, there may be a less active trading market for our ordinary shares and our share price may be more volatile.

***The market price of our ordinary shares could be negatively affected by future sales of our ordinary shares.***

Future sales by us or our shareholders of a substantial number of ordinary shares in the public market, or the perception that these sales might occur, could cause the market price of our ordinary shares to decline or could impair our ability to raise capital through a future sale of, or pay for acquisitions using, our equity securities. Shares held by our pre-IPO shareholders are now eligible for sale under Rule 144 of the Securities Act, which could cause additional downward pressure on the market price of our ordinary shares.

In January 2017, May 2017 and December 2018, Fortissimo Capital resold ordinary shares into the public market, via underwritten offerings that were effected pursuant to its registration rights, following which it no longer holds any ordinary shares. An additional security holder – Amazon – is also entitled to certain registration rights under the U.S. Securities Act of 1933, effective as of January 10, 2018, in respect of the resale of the ordinary shares underlying the warrants that it holds. All shares sold pursuant to an offering covered by a registration statement will be freely transferable except if purchased by an affiliate. See "ITEM 7.B — Related Party Transactions — Investors' Rights Agreement." and "ITEM 10.C – Material Contracts – Agreements with Amazon."

As of December 31, 2018, options to purchase 619,711 ordinary shares granted to employees and office holders were vested and exercisable and 22,597 RSUs were vested. We have filed registration statements on Form S-8 under the Securities Act registering ordinary shares that we may issue under our share incentive plans, of which as of December 31, 2018 there were options to purchase 1,583,564 shares and 414,420 RSUs outstanding. Shares included in such registration statements may be freely sold in the public market upon issuance, except for shares held by affiliates who have certain restrictions on their ability to sell.

***Under Section 404 of the Sarbanes-Oxley Act and as an emerging growth company, we are currently not required to obtain an auditor attestation regarding our internal control over financial reporting, but may need to obtain that in the near future, which may require enhanced actions on our part that we may not successfully implement.***

We are required to comply with the evaluation and certification requirements of Section 404 of the Sarbanes-Oxley Act with respect to internal control over financial reporting as of this annual report. Once we no longer qualify as an “emerging growth company” under the JOBS Act and lose the ability to rely on the exemptions related thereto (which, as discussed above, may occur as of the end of 2019), our independent registered public accounting firm will need to attest to the effectiveness of our internal control over financial reporting under Section 404. To maintain the effectiveness of our disclosure controls and procedures and our internal control over financial reporting, we may need to continue enhancing existing, and implement new, financial reporting and management systems, procedures and controls to manage our business effectively and support our growth in the future. Irrespective of compliance with Section 404, any failure of our internal controls could have a material adverse effect on our stated results of operations and harm our reputation. If any such failure were to occur, we may be required to take remedial actions and make required changes to our internal control over financial reporting and we may experience higher than anticipated operating expenses, as well as higher independent auditor fees during and after the implementation of these changes. If we are unable to implement any of the required changes to our internal control over financial reporting effectively or efficiently or are required to do so earlier than anticipated, it could adversely affect our operations, financial reporting and/or results of operations and could result in an adverse opinion on internal controls from our independent auditors.

***Our U.S. shareholders may suffer adverse tax consequences if we are classified as a passive foreign investment company.***

Generally, if for any taxable year 75% or more of our gross income is passive income, or at least 50% of the average quarterly value of our assets (which may be determined in part by the market value of our ordinary shares, which is subject to change) are held for the production of, or produce, passive income, we would be characterized as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. Based on historic and certain estimates of our gross income, gross assets and market capitalization (which may fluctuate from time to time) and the nature of our business, we believe we were not a PFIC for the taxable year ending 2018 and we do not expect that we will be classified as a PFIC for the taxable year ending December 31, 2019. Because PFIC status is based on our income, assets and activities for the entire taxable year, it is not possible to determine whether we will be characterized as a PFIC for our 2019 taxable year until after the close of the year. There can be no assurance that we will not be considered a PFIC for any taxable year. If we are characterized as a PFIC, our U.S. shareholders may suffer adverse tax consequences, including having gains realized on the sale of our ordinary shares treated as ordinary income, rather than as capital gain, the loss of the preferential rate applicable to dividends received on our ordinary shares by individuals who are U.S. Holders (as defined in "ITEM 10.E Taxation and Government Programs—U.S. Federal Income Taxation"), and having interest charges apply to distributions by us and the proceeds of sales of our ordinary shares. Certain elections exist that may alleviate some of the adverse consequences of PFIC status and would result in an alternative treatment (such as mark-to-market treatment) of our ordinary shares. For a more detailed discussion, see "ITEM 10.E Taxation and Government Programs—U.S. Federal Income Taxation—Passive Foreign Investment Company Considerations."

***Certain U.S. holders of our ordinary shares may suffer adverse tax consequences if we or any of our non-U.S. subsidiaries are characterized as a "controlled foreign corporation", or a CFC, under Section 957(a) of the Internal Revenue Code of 1986, as amended, or the Code.***

A non-U.S. corporation is considered a CFC if more than 50 percent of (1) the total combined voting power of all classes of stock of such corporation entitled to vote, or (2) the total value of the stock of such corporation, is owned, or is considered as owned by applying certain constructive ownership rules, by United States shareholders who own stock representing 10% or more of the vote or (for the taxable year of a non-U.S. corporation beginning after December 31, 2017 and for taxable years of shareholders with or within which such taxable years of such non-U.S. corporation ends) 10% or more of the value on any day during the taxable year of such non-U.S. corporation ("10% U.S. Shareholders"). Generally, a 10% U.S. Shareholder of a CFC is required to include currently in gross income such 10% U.S. Shareholder's share of the CFC's "Subpart F income", a portion of the CFC's earnings to the extent the CFC holds certain U.S. property, and certain other new items under the Tax Cuts and Jobs Act of 2017, or the Tax Act. Such 10% U.S. Shareholders are subject to current U.S. federal income tax with respect to such items, even if the CFC has not made an actual distribution to such shareholders. "Subpart F income" includes, among other things, certain passive income (such as income from dividends, interests, royalties, rents and annuities or gain from the sale of property that produces such types of income) and certain sales and services income arising in connection with transactions between the CFC and a person related to the CFC.

Certain changes to the CFC constructive ownership rules introduced by the Tax Act may cause one or more of our non-U.S. subsidiaries to be treated as CFCs, may also impact our CFC status and, thus, may affect holders of our common shares that are United States shareholders. For 10% U.S. Shareholders, this may result in adverse U.S. federal income tax consequences, such as current U.S. taxation of Subpart F income and of any such shareholder's share of our accumulated non-U.S. earnings and profits (regardless of whether we make any distributions), taxation of amounts treated as global intangible low-taxed income under Section 951A of the Code with respect to such shareholder, and being subject to certain reporting requirements with the U.S. Internal Revenue Service. Any 10% U.S. Shareholder should consult its own tax advisors regarding the U.S. tax consequences of acquiring, owning, or disposing our common shares and the impact of the Tax Act, especially the changes to the rules relating to CFCs. We have taken steps with the assistance of external tax consultants to prevent our subsidiaries from being treated as CFCs subsidiaries and it is not expected that any of the subsidiaries will be treated as CFCs.

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**Risks Related to Our Operations in Israel**

***Our headquarters, manufacturing and other significant operations are located in Israel and, therefore, our results may be adversely affected by political, economic and military instability in Israel.***

Our headquarters, research and development and manufacturing facility, and the primary manufacturing facilities of our third-party manufacturers, are located in Israel. In addition, the majority of our key employees, officers and directors are residents of Israel. Accordingly, political, economic and military conditions in Israel may directly affect our business. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its neighboring countries. In recent years, these have included hostilities between Israel and Hezbollah in Lebanon and Hamas in the Gaza Strip, both of which resulted in rockets being fired into Israel, causing casualties and disruption of economic activities. In addition, Israel faces threats from more distant neighbors, in particular, Iran. Our commercial insurance does not cover losses that may occur as a result of an event associated with the security situation in the Middle East. Although the Israeli government is currently committed to covering the reinstatement value of direct damages that are caused by terrorist attacks or acts of war, we cannot assure you that this government coverage will be maintained, or if maintained, will be sufficient to compensate us fully for damages incurred. Any losses or damages incurred by us could have a material adverse effect on our business. While we have commenced implementation of a business continuity plan which provides for alternative sites outside of Israel, there can be no assurance that such plan will be successful. Any armed conflict involving Israel could adversely affect our operations and results of operations.

Further, our operations could be disrupted by the obligations of personnel to perform military service. As of December 31, 2018, we had 277 employees based in Israel, certain of whom may be called upon to perform up to 54 days in each three year period (and in the case of non-officer commanders or officers, up to 70 or 84 days, respectively, in each three year period) of military reserve duty until they reach the age of 40 (and in some cases, depending on their specific military profession up to 45 or even 49 years of age) and, in certain emergency circumstances, may be called to immediate and unlimited active duty. Our operations could be disrupted by the absence of a significant number of employees related to military service, which could materially adversely affect our business and results of operations.

Several countries, principally in the Middle East, restrict doing business with Israel and Israeli companies, and additional countries may impose restrictions on doing business with Israel and Israeli companies whether as a result of hostilities in the region or otherwise. In addition, there have been increased efforts by activists to cause companies and consumers to boycott Israeli goods based on Israeli government policies. Such actions, particularly if they become more widespread, may adversely impact our ability to sell our solutions.

In addition, the shipping and delivery of our systems and ink and other consumables from our manufacturing facilities and those of our third-party manufacturers in Israel could be delayed or interrupted by political, economic, military,

and other events outside of our reasonable control, including labor strikes at ports in Israel or at ports of destination, military attacks on transportation facilities or vessels, and severe weather events. If delivery and installation of our products is delayed or prevented by any such events, our revenues could be materially and adversely impacted.

***The government tax benefits that we currently receive require us to meet several conditions and may be terminated or reduced in the future, which would increase our costs.***

We and our wholly-owned Israeli subsidiary, Kornit Digital Technologies Ltd., or Kornit Technologies, are entitled to various tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959, or the Investment Law. As a result of this status, we expect to have a reduced tax rate for our taxable income generated in Israel in 2019. However, if we do not meet the requirements for maintaining these benefits, the tax benefits may be reduced or cancelled and the relevant operations would be subject to Israeli corporate tax at the standard rate, which is currently set as 23% for 2018 and thereafter. In addition to being subject to the standard corporate tax rate, we could be required to refund any tax benefits that we have already received, as adjusted by the Israeli consumer price index, plus interest and penalties thereon. Even if we continue to meet the relevant requirements, the tax benefits that our current beneficiary enterprises receive may not be continued in the future at their current levels or at all. If these tax benefits would be reduced or eliminated, the amount of taxes that we pay would likely increase, as all of our operations would consequently be subject to corporate tax at the standard rate, which could adversely affect our results of operations. Additionally, if we increase our activities outside of Israel, for example, via acquisitions, our increased activities may not be eligible for inclusion in Israeli tax benefit programs. See "ITEM 5. Operating and Financial Review and Prospects - Taxation and Israeli Government Programs Applicable to our Company — Law for the Encouragement of Capital Investments, 5719-1959."

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***We received Israeli government grants for certain research and development activities. The terms of those grants restrict our ability to transfer manufacturing operations or technology outside of Israel.***

Our research and development efforts were financed in part through grants from the Israeli National Authority for Technological Innovation, or the Innovation Authority (previously known as the Israeli Office of the Chief Scientist), which we repaid in full in 2015. Even though we have fully repaid our Innovation Authority grants, we must nevertheless continue to comply with the requirements of the Encouragement of Research, Development and Technological Innovation in the Industry Law, 5744-1984 (formerly known as the Law for the Encouragement of Research and Development in Industry 5744-1984), and related regulations, or collectively, the Innovation Law.

When a company develops know-how, technology or products and related services using grants provided by the Innovation Authority, the terms of these grants and the Innovation Law, among others, restrict the transfer outside of Israel of such Innovation Authority-supported know-how (including by a way of license for research and development purposes), the transfer inside Israel of such know-how and the transfer of manufacturing or manufacturing rights of such products, and technologies outside of Israel, without the prior approval of the Innovation Authority. We may not receive those approvals.

Although we have repaid our grants in full, we remain subject to the restrictions set forth under the Innovation Law, including:

*Transfer of know-how outside of Israel*. Transfer of the know-how that was developed with the funding of the Innovation Authority outside of Israel requires prior approval of the Innovation Authority, and, if approved will require, the payment of a redemption fee, which cannot exceed 600% of the grant amount plus interest. Upon payment of such fee, the know-how and the production rights for the products supported by such funding cease to be subject to the Innovation Law.

*Local manufacturing obligation.* The terms of the grants under the Innovation Law require that the manufacturing of products resulting from the Innovation Authority funded programs are carried out in Israel, unless a prior written approval of the Innovation Authority is obtained. Such approval may be given in special circumstances and upon the fulfillment of certain conditions set forth in the Innovation Law, including payment of increased royalties. Such approval is not required for the transfer of less than 10% of the manufacturing capacity in the aggregate, and in such event, a notice to the Innovation Authority is required.

*Certain reporting obligations*. A recipient of a grant or a benefit under the Innovation Law is required to notify the Innovation Authority of events enumerated in the Innovation Law.

These restrictions and requirements for payment may impair our ability to sell our technology assets outside of Israel or to outsource or transfer manufacturing activities with respect to any product or technology outside of Israel; however, they do not restrict the export of our products that incorporate know how funded by the Innovation Authority. Furthermore, the consideration available to our shareholders in a sale transaction involving the actual transfer outside of Israel of technology or know-how developed with funding by the Innovation Authority pursuant to a merger or similar transaction may be reduced by any amounts that we are required to pay to the Innovation Authority. Failure to comply with the requirements under the Innovation Law may subject us to mandatory repayment of grants received by us, together with interest and penalties, as well as expose us to criminal proceedings.

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***Provisions of Israeli law and our articles may delay, prevent or otherwise impede a merger with, or an acquisition of, our company, even when the terms of such a transaction are favorable to us and our shareholders.***

Israeli corporate law regulates mergers, requires tender offers for acquisitions of shares above specified thresholds, requires special approvals for transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to such types of transactions. For example, a tender offer for all of a company's issued and outstanding shares can only be completed if the acquirer receives positive responses from the holders of at least 95% of the issued share capital, otherwise, the acquirer may not own more than 90% of a company's issued and outstanding share capital. Completion of the tender offer also requires approval of a majority in number of the offerees that do not have a personal interest in the tender offer, unless at least 98% of the company's outstanding shares are tendered. Furthermore, the shareholders, including those who indicated their acceptance of the tender offer (unless the acquirer stipulated in its tender offer that a shareholder that accepts the offer may not seek appraisal rights), may, at any time within six months following the completion of the tender offer, petition an Israeli court to alter the consideration for the acquisition. See "ITEM 10.B — Articles of Association — Acquisitions under Israeli Law."

Our articles provide that our directors (other than external directors) are elected on a staggered basis, such that a potential acquirer cannot readily replace our entire board of directors at a single annual general shareholder meeting.

Furthermore, Israeli tax considerations may make potential transactions unappealing to us or to our shareholders whose country of residence does not have a tax treaty with Israel exempting such shareholders from Israeli tax. For example, Israeli tax law does not recognize tax-free share exchanges to the same extent as U.S. tax law. With respect to mergers involving an exchange of shares, Israeli tax law allows for tax deferral in certain circumstances but makes the deferral contingent on the fulfillment of a number of conditions, including, in some cases, a holding period of two years from the date of the transaction during which sales and dispositions of shares of the participating companies are subject to certain restrictions. Moreover, with respect to certain share swap transactions in which the sellers receive shares in the acquiring entity that are publicly traded on a stock exchange, the tax deferral is limited in time, and when such time expires, the tax becomes payable even if no disposition of such shares has occurred. In order to benefit from the tax deferral, a pre-ruling from the Israel Tax Authority might be required.

***It may be difficult to enforce a judgment of a U.S. court against us or our officers and directors, to assert U.S. securities laws claims in Israel or to serve process on our officers and directors.***

We are incorporated in Israel. The majority of our directors and executive officers reside outside of the United States, and most of our assets and most of the assets of these persons are located outside of the United States. Therefore, a judgment obtained against us, or any of these persons, including a judgment based on the civil liability provisions of the U.S. federal securities laws, may not be collectible in the United States and may not be enforced by an Israeli court. It also may be difficult for you to effect service of process on these persons in the United States or to assert U.S.

securities law claims in original actions instituted in Israel. Israeli courts may refuse to hear a claim based on an alleged violation of U.S. securities laws reasoning that Israel is not the most appropriate forum in which to bring such a claim. In addition, even if an Israeli court agrees to hear a claim, it may determine that Israeli law and not U.S. law is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proven as a fact by expert witnesses, which can be a time consuming and costly process. Certain matters of procedure will also be governed by Israeli law. There is little binding case law in Israel that addresses the matters described above. As a result of the difficulty associated with enforcing a judgment against us in Israel, you may not be able to collect any damages awarded by either a U.S. or foreign court. It may be difficult to enforce a judgment of a U.S. court against us, our officers and directors or the Israeli experts named in this prospectus supplement in Israel or the United States, to assert U.S. securities laws claims in Israel or to serve process on our officers and directors and these experts.

***Your rights and responsibilities as a shareholder are governed by Israeli law, which differs in some material respects from the rights and responsibilities of shareholders of U.S. companies.***

The rights and responsibilities of the holders of our ordinary shares are governed by our articles and by Israeli law. These rights and responsibilities differ in some material respects from the rights and responsibilities of shareholders in U.S.-based corporations. In particular, a shareholder of an Israeli company has a duty to act in good faith and in a customary manner in exercising its rights and performing its obligations towards the company and other shareholders, and to refrain from abusing its power in the company, including, among other things, in voting at a general meeting of shareholders on matters such as amendments to a company’s articles of association, increases in a company’s authorized share capital, mergers and acquisitions and related party transactions requiring shareholder approval. In addition, a shareholder who is aware that it possesses the power to determine the outcome of a shareholder vote or to appoint or prevent the appointment of a director or executive officer in the company has a duty of fairness toward the company. There is limited case law available to assist us in understanding the nature of this duty or the implications of these provisions. These provisions may be interpreted to impose additional obligations and liabilities on holders of our ordinary shares that are not typically imposed on shareholders of U.S. corporations.

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**ITEM 4. Information on the Company.**

**A. History and Development of the Company**

**Our History**

Our legal name is Kornit Digital Ltd. and we were incorporated under the laws of the State of Israel on January 16, 2002.

In April 2015, we completed our initial public offering, or IPO, pursuant to which we sold 8.165 million ordinary shares for aggregate gross proceeds (before underwriting discounts, commissions and expenses) of $81.65 million. Our ordinary shares began trading on the NASDAQ Global Select Market, under the symbol "KRNT," on April 2, 2015. On January 31, 2017, we completed a follow-on offering pursuant to which we sold 2.3 million ordinary shares for aggregate gross proceeds (before underwriting discounts, commissions and expenses) of $38.0 million.

We are subject to the provisions of the Israeli Companies Law, 5759-1999. Our principal executive offices are located at 12 Ha'Amal Street, Rosh Ha'Ayin 4809246, Israel, and our telephone number is +972-3-908-5800. Our website address is www.kornit.com (the information contained therein or linked thereto shall not be considered incorporated by reference in this annual report). Our agent for service of process in the United States is Kornit Digital North America Inc., located at 10541-10601 North Commerce Street, Mequon, Wisconsin 53092, and its telephone number is (262) 518-0200.

**Principal Capital Expenditures**

Capital expenditures in the years ended December 31, 2017 and 2018 were principally used for the purchase of property, plant and equipment ($5.7 million and $7.3 million in 2017 and 2018, respectively), including $1.8 million, in the aggregate invested over the course of those two years towards our now-complete, new headquarters in the United States. On February 7, 2019, we consummated an asset purchase from Hirsch Solutions Inc., our primary distributor in the United States and Canada, which accounted for 21%, 18% and 15% of our revenues in the years ended December 31, 2016, 2017 and 2018, respectively, to purchase remaining Kornit business assets related to the distribution agreement between the companies. On the closing date, our company, through our wholly owned subsidiary Kornit Digital North America Inc., took ownership of relevant Kornit-related customer business assets as well as remaining inventory of systems and ink. Under the related acquisition agreement, the total consideration was $4.7 million. Our current capital expenditures relate primarily to our manufacturing facility for our ink and other

consumables in Kiryat Gat, Israel. We are financing the construction of that facility from cash on hand.

Capital expenditures in the year ended December 31, 2016 for purchase of property, plant and equipment, and the digital direct to garment printing assets of SPSI Inc. (which were acquired in July 2016), were $14.7 million, in the aggregate.

**B. Business Overview**

**Industry Overview**

**The General Textile Industry**

Textile is a flexible material formed using various processes, including weaving, knitting, crocheting or felting. This material may be used for manufacturing a broad range of conventional as well as advanced, finished goods, which may be broadly categorized (as related to the focus of our business) into fashion, apparel, home decoration and soft signage applications. According to a report published by Marketline in December 2018, the value of the global apparel retail market totaled $1.4 trillion in 2017. The compound annual growth rate (CAGR) of the market was 4.4% between 2013 and 2017. The global apparel retail market is forecast to reach $1.8 trillion in 2022, an increase of 29.7% since 2017, reflecting a CAGR of 5.3%. Rising disposable income, urbanization and population growth in emerging economies is expected to play an important role in improving the lifestyle of consumers, which is expected to drive the demand for textile products.

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The global printed textile industry involves printing on fabric rolls, finished garments and unsewn pieces of cut fabric at various stages along the value chain in the production of goods for (as related to the focus of our business) fashion, apparel, home decoration and soft signage applications. According to The Future of Digital Textile Printing report published by Pira in 2019, approximately 95% of the global output of printed textile in 2018 was carried out via analogue methods of printing. According to the same Pira report, the global value of digital printed textile output was estimated to be approximately $3.2 billion in 2018 and is expected to grow to approximately $5.5 billion by 2023, reflecting a CAGR of 11.6% in the five-year period from 2018 to 2023. According to the same Pira report, digital textile output volume was estimated to be approximately 2.2 billion square meters in 2018 and is expected to reach 4.1 billion square meters in 2023, reflecting a CAGR of 13.4% for the five-year period from 2018 to 2023. Pira estimates that global digital printed textile output constituted less than 5% of the total global printed textile output in 2018.

**Mega Trends Affecting Our Industry**

*Industry 4.0*

Digitization of manufacturing is transforming the way products are being produced. This transformation process is also broadly referred to as Industry 4.0, representing the fourth industrial revolution occurring in manufacturing. This fourth industrial revolution is mainly about full digitization and the move away from analogue production methods, as well as cloud networks connectivity, and the introduction of autonomous systems fueled by data and machine learning. As a result of the support of machines that keep getting smarter as they get access to more data, the increased use of affordable robotics in production environments, and the data-connected logistics supply chain, our future factories are predicted to become more efficient, productive and less wasteful. The fashion and apparel industry segments in which we operate have been operating for decades in traditional, analogue and labor-intensive models, which will yield to what can also be referred to as Textile 4.0.

*E-Commerce Boom*

E-commerce has grown globally at an unprecedented rate and is transforming retailing, across industries. Around the world, e-commerce is entirely changing the way people shop. In the major consumer markets of Europe, the U.S. and China, e-commerce is fast trending towards becoming the preferred shopping method for many people. Having access to global shopping opportunities allows consumers to save time, save money and have access to greater choices. E-commerce giants and technology vendors continue to invest in advanced technologies such as virtual reality, 3D modeling, augmented reality, and artificial intelligence in a continuous effort to improve the online shopping experience. Goldman Sachs estimated in a research report dated September 5, 2018 that the global ecommerce market (excluding travel) was worth approximately US $2 trillion in 2018, with a projected year-over-year CAGR of +20% until 2021. According to the same report, e-commerce was estimated to represent approximately 20.7%, 12.2%, and 9.4% of all retail sales in 2018 in China, the U.S. and Western Europe, respectively.

According to a global consumer survey performed by The Nilsen Company in 2018, fashion and apparel are, together, one of the top segments in ecommerce retail, predicted (according to a study published by Statista, the Statistics Portal) to increase at a compound annual rate of 10.6% from $408 billion in 2017 to more than $706 billion by 2022, as brands and retailers continue to adopt digital technologies that offer highly relevant and personalized customer experiences.

*Traditional Retail Meltdown*

For the last decade, various factors have resulted in the shrinking, bankruptcy/reorganization or total closing of numerous traditional North American retailers. Announcements from major retailers of plans to either discontinue or greatly scale back their retail presence continued in 2018 and into 2019. For example, Sears Holdings filed for bankruptcy protection in October 2018, J.C Penney has been closing stores, including in 2019, and Payless Shoesource has announced plans to close all of its stores in 2019. Credit Suisse, a major global financial services company, predicted that 25% of U.S. malls that remained in business in 2017 could close by 2022. According to a research report published by Goldman Sachs on September 5, 2018, approximately 27% of announced store closures in 2018 were in the apparel and accessories categories. The primary factors affecting the continued closing of traditional retail stores are the shift in consumer habits towards online shopping, a less than inspiring shopping experience at traditional brick-and-mortar stores, retailers' inability to sell trend-right apparel, and the ongoing pile-up of unsold inventory, which has put pressure on profits. Traditional retailers are struggling to find the right balance between supply and demand, so that they do not end up with too much inventory on their shelves or in stock rooms. When merchandise piles too high, traditional retailers are forced to use steep discounts to deplete inventory and make room for next season's goods. Further, e-commerce share gains continue to put pressure on traditional retail stores that are finding it difficult to compete with the level of selection, price, service, and convenience provided by many of the pure-play e-commerce companies or omni-channel retailers.

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*Social Media Platforms*

Social platforms, historically categorized into media and networks (which categories have merged in recent years), have changed the industrial and business landscape, both for companies that have adopted them and for those that have not. Social media platforms have an extremely powerful impact on the ways in which individuals and organizations are communicating with each other, and a powerful impact on consumer trends, demand and brands perception. This mainstream effect has a dramatic impact on the ability of small and micro brands, some of which are initiated by individuals or organizations that are leveraging their social influence status to inspire individuals who, in turn, purchase those brands' products, to achieve ultra-fast recognition and exponential growth at the expense of traditional players, which need to develop agility in order to connect with consumers.

*Sustainability*

The need to reduce or contain the ecological footprint of the textile industry is affecting the entire industrial system. The urgency for change has flowed through from political and environmental activists and scientists, into mainstream government regulators and business leadership across the globe. A sustainable industrial system requires formulation of new strategies and thinking, integrated into business and operational frameworks around sustainable manufacturing, supply chain design, sustainability performance measurement and ongoing management. Industry is now considered not only part of the problem but also part of the solution. From a practical point of view, as it comes to sustainability strategies, companies are focused on technology improvements enabling cleaner production, pollution prevention, and other sustainable manufacturing practices. Considering the size of the textile industry— one of the largest in the world—sustainability of the industry is important, but, on top of that, companies can furthermore make a huge difference environmentally, economically and socially. The textile industry has many reasons to place an emphasis on sustainability, including reduced costs, protection of the environment and sustained goodwill from its customers for eco-friendly practices. As one of the world's most water and air polluting industries, sustainability issues in the textile/apparel industry continue to receive great attention.

**Mega Consumer Trends Affecting our Industry**

*Personal Expression*

We believe that modern consumers, impacted by the mega industry trends, are increasingly seeking the ability to express their identities and beliefs through the everyday choices that they make. If in the past it was mainly about the choice of brand affiliation that was considered "appropriate" for their self-image, consumers are now seeking new and creative ways to express their identities through unique, customized or personalized impressions, styles, and messages

– whether affiliated with their favorite brands, through the creation of their own “private brands” or via affiliation with unique “no brand” designed goods. Younger consumers are more and more concerned with social and environmental causes, as many increasingly back their beliefs with their tightly coupled expression and consumption habits, favoring goods and brands that are aligned with their personal, social and environmental values and avoiding those that do not.

*Instant Gratification*

Modern consumers seek solutions faster and easier than ever before, catalyzed by the explosive growth of technology and mobile applications usage. This shift has given way to an on-demand economy where immediate gratification has become the standard across industries, in the form of instant arrival rides in the transportation industry, unlimited on-demand video streaming, minimal wait time for food deliveries, or in the case of retail, instant visibility and availability of product and inventory, and ultra-fast delivery. Consumers expect to be serviced almost instantaneously and are rewarding the brands that understand and meet their instant gratification needs. According to a 2018 report published by Internet Retailer, 66.8% of the top 1,000 retailers in North America offer free shipping and 55.6% offer the option to pay for next-day delivery. A recent study published by Consumer Intelligence Research Partners in January 2019 estimated that the number of Amazon customers in the United States willing to pay more to receive products faster, through its Amazon Prime service, exceeded 100 million as of December 2018. This change in consumer behavior is causing retailers to evaluate ways to alter their approach towards their entire supply chain, with high focus on improved inventory management and an efficient and scalable fulfillment infrastructure. In addition to retooling their internal fulfillment capabilities, many retail brands have begun to leverage the capacity of third-party online stores to meet customer demands for delivery speed and product availability.

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*Social Media Influence*

With the rise of mega social platforms like YouTube and Instagram, and fueled by the explosive mobile device accessibility, influencer marketing continues making waves on social media and narrowing the bridge between discovery, inspiration and purchase. According to a 2017 millennial survey published by Dealspotr in 2017, most of today's consumers are likely to find inspiration from external sources rather than directly from a brand or retailer, and approximately 41% stated that they rely on social influencers and bloggers. According to another recent study conducted (the Robin Report by Catherine Schetting Salfino), 55% of millennials say that they are less loyal to apparel brands now than they were a few years ago. More than 1 in 5 say social media sites are the first places to which they go to get clothing ideas, a figure that jumps to 36% among those aged 13-to-25 and climbs to 46% among millennials aged 22-to-37.

*"Be Greener"*

Environmental degradation has been hitting headlines in recent years. News articles and documentaries around rising seas, declining air quality and shrinking animal populations have become more commonplace. Sales of reusable coffee cups and water bottles took off, plastic straws were banned in many bars and restaurants, and mega consumer brands like Evian and Coca-Cola have committed to manufacture from recycled materials. The impulse to "be greener" is clearly gaining momentum. According to a recent bespoke study carried out in the UK and U.S. by Globalwebindex, half of the digital consumers surveyed said environmental concerns impact their purchasing decisions. Millennials are the ones driving the sustainable movement with their lifestyle and behavioral changes. Often coined as the "green generation", many brands are starting to see the appeal of, and the opportunity to connect with their consumers through, these changes, rather than viewing the changes as a regulatory burden. According to the Globalwebindex study, 60% of millennials aged 22-35 said that they would be more likely than any other generation to pay extra for ecofriendly or sustainable products. With plastic waste currently at the center stage of consumers' attention, it is likely just a matter of time before consumers better research the manufacturing processes and decoration techniques for their clothes, shoes and bags before buying them, which will increase pressure on brands to connect with the consumer by adopting eco-friendly printing and decoration methods that minimize water pollution, toxic chemicals use and other textile waste.

**Implications on Fashion and Apparel Transformation, as it Relates to our Business**

Regardless of size and specific segment, industry players in fashion and apparel, whether traditional brands, digital start-ups, new generation e-tailers, or different forms of customized designers, now need to be nimble, think digital-first and achieve ever-faster speed to market. They need to connect to the end consumer for self-expression, take an active stance on social issues, satisfy consumer demands for ultra-transparency and sustainability, and ensure that they invest in an omni-channel strategy, thereby enhancing their manufacturing productivity, supply chain

resilience and their ability to respond to the immediate gratification needs of the evolving consumer. Traditional brands are beginning to self-disrupt their own business models, image and offering in response to the new breed of emerging high growth online-first brands that are accelerating, thanks to changing consumer preferences, decreasing brand loyalty, growing appetite for self-expression, and instant gratification. We expect more traditional brands to follow suit on this omni-channel path of self-disruption, which will have a significant impact on their ability to connect with, and meet the needs of, consumers. In a recent survey conducted by a leading management consulting firm, top industry executives were asked to describe the words that best describe the industry, with the top three words being: “Changing”, “Digital”, and “Fast”.

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We believe that the following objectives capture some of the key areas of focus, as they relate to our business, as traditional and new generation online-first fashion and apparel players continue to adapt their value propositions and operating models to the rapidly changing industry environment and consumer preferences. We believe that these industry areas of focus will continue to fuel the growing need and demand for our innovative digital textile printing solutions:

Connect with consumers need for self-expression via unique graphical and text designs

Capture the moment, by shortening the time from inspiration and design to market

Offer “unlimited” variety and availability in their virtual and traditional storefronts

Connect with consumers via personalization and customization offerings

Respond to the sustainability demands of consumers and regulators

Respond to consumers’ immediate gratification needs

**Impact on the Industry Need and Demand for Operational Transformation**

New generation start-up apparel and fashion businesses born and grown in digital and online retail and production, some of which are existing customers of our solutions, have already implemented successful full or partial on-demand production models as they establish their greenfield environments. We expect these businesses to continue scaling and perfecting their existing digital business and operational models, investing in front-end technologies to continue improving the online customer experience, and operationally scaling their partial or full on-demand production capabilities.

We believe that in order to address the focus areas identified above, traditional industry and brands players will continue to examine and transform their predominantly mass production and inefficient analogue operating production models and supply chains, especially as it comes to managing their finished goods inventory levels, which remains a huge financial risk. Traditional companies have continued to invest “upstream the chain” in better predicting buying trends, consumer preferences, and demand via sophisticated big-data analytics, as they plan their collections and inventory levels; however, consumer demand is more volatile and difficult to predict than ever. The challenge with prediction-only production planning is growing, and industry executives, as evidenced in a 2018 study published by a leading management consulting firm, are increasingly shifting their focus “downstream” to the manufacturing environment, seeking a shift to a more agile, partial or full on-demand production model. We believe that industry players will continue to seek ways to adopt major changes to their business and operational models, and supply chains, and— specifically as it relates to our business— in how they design, produce, and decorate garments and apparel.

The below lists a few key production gaps, that prevent a successful transition to partial or full on-demand retailing models, that traditional fashion and apparel manufacturers are looking to close as they plan their future marketing and production strategies:

*Mass Customization and Personalization:* The capability to manufacture a relatively high volume of product options, carrying unique designs, without tradeoffs in cost, delivery and quality. In a simplified way, the ability to cater demand to mass produce customizable products with unlimited designs, on a one-by-one basis, in a cost-efficient manner.

*"Shorter Runs":* Mass production of smaller batches with (most likely) higher number of order amounts, at a similar cost per garment structure achieved by producing large batches. This flexibility reduces finished goods inventory risks by identifying buying patterns and responding to demand in a more accurate manner by replenishing stock in ultra-short cycles. The pressure for smaller batch sizes and on-demand replenishment is driven partly by profitability, but also by a desire for sustainability.

*Proximity Production, Proximity Decoration and Nearshoring:* Two decades ago, U.S. and European mass-market apparel brands and retailers shifted production to Asia to gain a cost advantage. Factors are changing this calculus by making it critical for companies to bring new styles to market more quickly and switch out lines mid-season. According to a recent 2018 survey published by a leading management consulting firm, 54% of purchasing managers surveyed in the US and the EU said that proximity to customers is becoming more important. In another study published by a leading management consulting firm, 60% of apparel procurement executives said that they expect that over 20% of their sourcing volume will be from nearshore by 2025. In addition, rising wages for factory workers across Asia mean that production in Asia is less cost-efficient than it used to be. The real prize is shorter lead times. By reducing time-to-market, companies can produce, partially produce, finish, print or decorate more closely in-line with demand, reducing overstocks and increasing full-price sell-through.

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*Microfactories, Speedfactories, Reshoring:* Smaller and nimble manufacturing sites, usually planned out in an urban cell model, that can efficiently source or produce the raw materials as well as produce and ship finished apparel goods end-to-end. Success of such factories is heavily reliant on a fully digital, real-estate efficient, either semi or fully automated manufacturing workflow capability that offsets the inefficient cost structure associated with large analogue equipment, rising costs of real-estate and labor costs, predominantly in developed countries.

We believe that the technology and solutions that we bring to the market in the form of digital textile printing solutions, as listed in our products and technology sections, are key enablers for these business and operating models. We expect increasing demand and adoption of our solutions by start-ups and new-generation digital apparel brands (some of which are our customers), as well as from traditional apparel brands that need to adapt their operational models in order to remain connected with their customers.

**Overview of Textile Printing Processes**

The graphic and accompanying description below present various textile printing processes:

Screen printing is the most commonly used printing process for textiles. The two primary methods of screen printing are rotary screen printing and automated carousel screen printing.

The following chart summarizes the key steps involved in the analog printing process:

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***Rotary Screen Printing*** Rotary screen printing is commonly used to print on outerwear, underwear, sportswear, upholstery and linens. It involves multiple, time-consuming process steps. Rolls of fabric pass through rotating cylinders that are engraved with the image or design to be printed. Each cylinder then applies ink of a different color, which forms part of the image or design. This process is generally used to print a pattern on a fabric roll that is then cut and sewn into finished products. Rotary screen engraving is a costly process that takes between four and five hours per cylinder and is frequently done offsite. Preparation of colors typically takes an additional 30 minutes and the setup of the printer itself typically takes nearly 1.5 hours. The process can require up to seven people. The maximum size of an image or design is limited based on the circumference of the cylinders, which is typically no more than 60 centimeters.

The following diagram depicts the analog rotary screen printing process:

***Automated Carousel Screen Printing*** Automated carousel screen printing is commonly used to print on finished garments and cut pieces. In automated carousel screen printing, a blade or squeegee squeezes printing paste or ink through mesh stencils onto fabric. The process typically employs a series of printing stations arranged in a carousel. At each station, one color of ink is pressed through specially prepared mesh stencils, or screens, on to the textile surface. Between color stations, there are also flash drying stations and cool-down stations to ensure that deposited ink does not inadvertently mix with the next color to be applied. Preparation of the mesh stencils is a specialized process and its complexity is a function of the number of discrete color separations and screens that need to be prepared for a given design. The process of color separations, film production, and screen exposure and alignment, typically takes approximately 1.5 hours for six colors. Once the screens and color separations are complete, preparation of the carousel typically takes between 40 and 60 minutes. After being manually loaded, the textile moves along the carousel from station to station where each color is applied separately. Unlike rotary screen printing, carousel screen printing does not require fixing the image or design with steam or hot air and, in most cases, does not require washing and drying the textile afterward

***Digital Printing Processes***

Digital textile printing uses specially engineered inkjet heads, rather than screens and cylinders or mesh stencils, to print images and designs directly onto fabrics. As such, the use of digital technology eliminates multiple complicated, costly and time-consuming steps, such as screen preparation or cylinder engraving, preparation of pastes or inks, and screen or cylinder alignment.

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Most fabrics need to be pre-treated before printing by submerging them in a solution that is designed specifically for the type of fabric and ink being used. This coating process is essential for achieving the desired chemical reaction between the ink and the fabric. The fabric is dried following pre-treatment. After the ink drops are applied, the printed fabric undergoes a process of fixation that is also specific to the type of fabric and ink being used. Digital textile printing generally uses either dye-based or pigment-based ink.

The digital textile printing market principally includes two types of printing processes:

**Direct-to-Garment (DTG)** In DTG printing, an inkjet printer prints directly on the textile. DTG printing allows for printing images and designs onto finished textiles, such as t-shirts that have already been sewn and dyed. The following chart summarizes the key steps involved in the DTG printing process:

**Direct-to-Fabric (DTF)** In DTF printing, rolls of fabric pass in-line through wide-format inkjet printers that are utilized to directly print images and designs onto rolling fabric. The following chart summarizes the key steps involved in the DTF printing process:

Recent technological developments in digital printing have supported the adoption of digital printing by the global printed textile industry, including by custom decorators, online businesses, brand owners and contract printers. As a result of consumer and macro trends impacting these businesses, we believe that the global printed textile industry offers a significant and rapidly growing market for digital printing solutions.

**How Digital Textile Printing Addresses the Industry Needs**

The following characteristics of digital textile printing enable new business and operating models, help industry players as they address their manufacturing gaps, and, as these characteristics relate to our business, are driving the shift from analog to digital textile printing:

*Manufacturing flexibility:* Digital textile printing allows a full image or design to be printed on a garment or cut fabric in one manufacturing step, compared to multiple steps in an analog printing process. Digital textile printing gives manufacturers the ability to print short runs, with personalization capabilities, in a cost-effective manner with a minimum order quantity of one unit. Unlike screen printing, digital printing cost remains the same when printing a single unit or multiple units. This allows printers to execute orders one by one without needing to accumulate large demand for a design before printing.

*Design flexibility:* Digital textile printing enables a larger variety of artwork to be imprinted, without limitations on number of colors per design and high-resolution imaging.

*Integration with advanced workflow environments:* Digital textile printing is better suited for transition to full digitization of the production floor environment, including connectivity to cloud networking elements and productivity analytics software solutions.

*Reduced time between design and production:* The digital textile printing process allows for samples to be quickly produced, evaluated, and modified, which permits brand owners to increase the frequency and variety of replenishment cycles in response to fashion trends.

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*Decreased risk of excess inventory:* The costly and time-consuming upfront setup required in analog production methods is avoided when using digital printing technologies. Therefore, digital printing enables the cost-efficient production of a smaller quantity of garments, which mitigates excess inventory risk and improves profitability. Stocking blank garments or fabric and decorating them only when demand is identified significantly reduces the amount of inventory at risk. This reduces working capital requirements, thereby enabling the emergence of numerous online businesses which are focused on the sale of printed textiles.

*Reduced labor and physical space requirements:* Digital textile printing requires significantly less labor to print an equivalent output due to the significant reduction in process steps. The unique Kornit proprietary process of digital textile printing also reduces the need for floor space for manufacturing equipment by eliminating certain process steps and by consolidating multiple process steps into a single printing system. The combination of labor savings and smaller shop floor footprint, coupled with lower energy consumption and a lack of environmental impact, enables manufacturers to move production closer to consumers in a cost-effective manner. Textile business is very seasonal and the need to retain employees bares a heavy financial burden. The move to digital printing significantly reduces the need for manpower and allows for a more flexible cost structure.

*Sustainability:* Digital textile printing significantly reduces industrial water consumption and discharge of toxic chemicals by eliminating the need to wash screens for color changes and repeated use. We believe that this results in reduced environmental impact and, in turn, enables manufacturers to comply with regulatory and brand guidelines at a location of their choosing, in many cases in populated areas which are not industrial in nature.

**Our Business**

We develop, design and market innovative digital printing solutions for the global printed textile industry, with a major focus on the fashion, apparel and home décor segments of the industry.

Our vision is to create a world where everybody can bond, design and express their identities, one impression at a time.

Our mission is to revolutionize the fast-changing industry by facilitating and expediting the transition from analog processes that have not evolved for decades and are not fit for the rapidly changing business models and self-disruption needs of the industry, to digital methods of garment, apparel and home decor finished goods production and decoration that address the contemporary supply, demand, social and environmental needs of the industry in which we operate.

We focus on the rapidly growing high throughput, direct-to-garment, or DTG, and Direct-to-Fabric, or DTF, segments of the printed and decorated textile industry. Our solutions include our proprietary digital printing systems, ink and other consumables, associated software and value-added services that allow for quality and cost-effective large-scale printing of short runs of complex images and designs directly on finished garments and fabrics. Our solutions address the growing production gaps reflected in the need to shift to shorter runs, proximity production, proximity decoration, partial or full on-demand production, and microfactory models by enabling our customers to print and decorate high quality products in a time efficient, cost-effective and environmentally-friendly manner. This allows textile manufacturers to transition from their traditional business and operating models of supply based on demand predictions, to partial or full on-demand or made-to-order models, by which decoration of fabric and production of finished goods only takes place once a customer order has been issued.

Our solutions are differentiated from other digital methods of production because they eliminate the need to pre-treat fabrics prior to printing, thereby offering our customers the ability to digitally print high quality images and designs on a variety of fabrics in a streamlined and environmentally-friendly manner. When compared to analog methods of production, our solutions also significantly reduce production lead times and enable customers to more efficiently and cost-effectively produce smaller quantities of individually printed designs, thereby mitigating the risk of excess inventory, which is a significant challenge for the industry, as further described in our “Industry Overview” section above.

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The success of evolving omni-channel apparel retail is dependent heavily on the ability to show a large variety of designs. Since it is more and more difficult to predict consumer preferences and demand, it is increasingly difficult to stock every possible design. Having digital capacity available allows printers, brands and retailers to offer unlimited design with minimal to no inventory risk. We believe we are well positioned to continue taking advantage of this trend.

Our DTG solutions utilize our patented wet-on-wet printing methodology that eliminates the common practice of separately coating and drying textiles prior to printing. This methodology also enables printing on a wide range of untreated fabrics, including cotton, wool, polyester, lycra and denim. With throughputs ranging from 32 to 250 garments per hour, our entry level, industrial and mass production DTG solutions are suited to the needs of a variety of customers, from smaller industrial operators with limited budgets to mass producers with complex manufacturing requirements. Our patented NeoPigment ink and other consumables have been specially formulated to be compatible with our systems and overcome the quality-related challenges that pigment-based inks have traditionally faced when used in digital printing. Our software solutions simplify order to production workflows in the printing process, by offering a complete solution from web and traditional order intake through graphic job preparation and execution. We also offer customers maintenance and support services, as well as value-added services and application consulting, aimed at optimizing the number of impressions printed by our systems.

Building on the expertise and capabilities that we have accumulated in developing and offering differentiated solutions for the industrial DTG market, we also market an industrial digital printing solution, the Allegro, which targets the on-demand DTF market. While the DTG market generally involves printing on finished garments, the DTF market is focused on printing on fabrics that are subsequently converted into finished garments, home or office décor, and other items. The Allegro utilizes our proprietary wet-on-wet printing methodology and houses an integrated drying and curing system. It offers the first single-step eco-friendly, stand-alone industrial DTF digital textile printing solution available on the market. We primarily market the Allegro to innovative web-based businesses operating on-demand business models that require a high degree of variety and limited quantity orders, as well as to fabric converters, which source large quantities of fabric and convert untreated fabrics into finished materials to be sold to garment and home décor manufacturers. We believe that with the Allegro we are well positioned to take advantage of the growing trend towards customized home décor and on-demand fabric printing. We began selling the Allegro commercially in the second quarter of 2015.

We were founded in 2002 in Israel, shipped our first system in 2005 and, as of December 31, 2018, had more than 1,200 customers globally. As of December 31, 2018, we had 444 employees located across four regions: Israel, America, Europe and Asia Pacific. In the year ended December 31, 2018, we generated revenues of $142.4 million, representing an increase of 24.8% over the prior fiscal year. In the year ended December 31, 2018, we generated 57.2% of our revenues from the Americas region, 31.8% from the Europe, Middle East and Asia (“EMEA”) region, and 11% from the Asia Pacific region.

**Our Competitive Strengths**

The following are our key competitive strengths:

***Leading player in the fast-growing industrial digital DTG market.***

We are the leading player in the fast-growing, industrial and mass production, digital DTG market based on our sales, and have more than 1,200 customers globally. We have been revolutionizing the industry since 2005 and have developed a robust solutions portfolio and scaled our go-to-market infrastructure over the course of this period. Other than our unique intellectual property and technology, and our robust go-to-market infrastructure, our application experts have the best industry knowledge. Consequently, we believe we can greatly support and advise our existing and future customers with the best-known methods to optimize their production environments. Our own internal estimates, based on our understanding of the industry, combined with data from available market reports on the estimated production quantities of garments, are that approximately 15 billion impressions were printed direct-to-garment in 2017 in the global apparel industry, including the decoration of, among other forms of garments, T-shirts, jerseys, and trousers. We estimate the number of annual impressions to grow to approximately 25 billion on an annualized run-rate basis, by the end of 2023. We estimate that only 1 to 2% of these impressions are printed digitally today. We therefore believe that our leadership position, combined with continued technology innovation, and operational improvements, will allow us to grow our business in the coming years.

***Well-positioned to disrupt the DTF market with our unique single-step manufacturing solution.*** We believe we are well positioned to capitalize on the growing trend toward on-demand home décor with our unique DTF solution. Our Allegro system, combined with our proprietary process, was designed to offer a single-step manufacturing solution which is especially suited for businesses which do not have a vertically- integrated textile mill. Unlike other digital textile printers, the Allegro does not require multiple pre-processing and post-processing steps that are customarily used in vertically integrated textile mills and that utilize high levels of energy and space and have a negative environmental impact. Given its architecture, it is perfectly suited for short and micro runs. Allegro is compact in size, requires a single person to operate, and fits very well in an urban and non-industrial setting. Allegro is unique in its ability to print on multiple fabric types without the need for different inks and consumables, while generally other systems and technologies for DTF digital printing require dedication of discrete printers to specific fabric types.

***Disruptive technology that enables our customers to adopt new, or improve existing, business models.*** Our digital printing solutions allow our customers to develop new, or improve existing, business and operational models by enabling them to produce short to medium runs of high-quality customized garments efficiently. This facilitates online business models that require an on-demand and made-to-order basis and allows brand owners to produce and decorate garments in-house. With a constantly growing worldwide customer base of approximately 1,200 customers, we are witnessing the creation of a global fulfillment network of printing specialists that are leveraged by large numbers of websites that offer customizable garment printing services. As demand from these customers continues to grow, so does utilization of our systems, which in turn print more impressions, consume more ink and once used to their full capacity, require purchasing of more systems.

***Attractive business model.*** We currently offer a broad portfolio of differentiated digital printing solutions for the digital industrial and mass production DTG market. Our existing and growing installed base of systems results in recurring sales of ink and other consumables, which are specially formulated to enable our systems to operate at the highest throughput level. These recurring sales are generated at attractive gross margins. Recurring sales of ink and other consumables have historically offered us a degree of visibility into a significant component of our results of operations. We believe that our recurring sales model also enables us to foster close customer relationships, as it facilitates ongoing engagement with our customers, which positions us to provide tailored solutions and expands our ability to provide value-added services to our customers. Our customer relationships are further strengthened by a trend towards ownership of multiple systems, as the number of customers with at least two systems has grown from 155 as of December 31, 2014, to 271 as of December 31, 2018, and the number of customers with at least 10 systems has grown from nine as of December 31, 2014, to 17 as of December 31, 2018. We anticipate revenue from services to increase over time as we reach upgrade cycles across our growing installed base and continue to expand our service contracts business model. Additionally, sales of ink and other consumables are generally higher in high throughput systems such as the Vulcan, Atlas, Avalanche and Allegro systems. Large customers typically run at high utilization rates and can consume up to five times as much ink per year compared to other customers. By developing and implementing proprietary end-to-end solutions for our customers, we believe our business model is differentiated from more commoditized solutions serving the same end markets. We have proven our ability to grow revenues while maintaining an attractive margin profile and we intend to continue investing in our business to drive profitable growth in the future.

***Product upgrade strategy.*** In 2016 we started implementing a long-term strategy for supporting our installed base with upgrade paths to newer, more advanced, systems. The goal of this strategy is to allow our customers to extend the return on their investment in Kornit systems, and in return, we enjoy growth in system utilization and on-going capital investments in our equipment through the depreciation cycle.

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***Robust intellectual property portfolio driven by an innovation-based culture.*** Our intellectual property portfolio reflects over a decade of significant investments in digital textile printing, which we believe creates significant barriers to entry. We have developed a strong base of technology know-how, backed by our portfolio of intellectual property, which includes 29 issued patents and 19 provisional or pending US applications, 31 pending non-US patent applications and 11 pending PCT applications that cover wet-on-wet printing methodology, ink formulations, printing processes and related methods and systems. Our team of over 115 researchers and developers, including chemists, electrical engineers, system engineers and mechanical engineers, ensures that our systems remain technologically advanced, and are well engineered, user-friendly and highly reliable.

***Extensive product portfolio and strong new product pipeline.*** With throughputs ranging from 32 to 250 garments per hour, our DTG systems are suited for smaller industrial operators with limited budgets, as well as mass producers with complex needs. Since 2015, we have commercialized four new solutions in the market: the Allegro, a one-step, integrated DTF printing, drying and curing system, the Vulcan, a cost-effective digital substitution for carousel screen printing, the HD family of solutions, and the Atlas, our recently introduced high throughput mass production digital DTG system. Our future roadmap remains focused on the continued development of proprietary processes, continuously expanding the breadth of applications upon which we can print while pushing the envelope of cost-efficient manufacturing further as a means to expand our servable addressable markets.

***At the heart of a true industrial revolution, or Textile 4.0.*** Every digital printing revolution starts with printing small quantities of particular designs where the advantages of digital technology are most pronounced. The ability to expand the addressable market of digital printing relies heavily on constant reduction of cost per printed unit (CPP). Given our deep technological foundations, we have been able to constantly reduce CPP by increasing system output as well as increasing the efficiency of our inks, allowing customers to consume less ink while achieving excellent results. Given this progression, we are now able to offer a cost-effective alternative to screen printing for runs of up to 500 garments, making our products a viable printing solution for large scale retailers who now seek to move to quick inventory replenishment and are constantly moving to shorter runs of production.

***Environmentally-friendly printing processes.*** A significant portion of global industrial water pollution comes from textile dyeing, printing and finishing. We believe that environmental factors are beginning to assume a significant role in the decision-making process of our existing and potential customers, with an increasing number of countries adopting restrictions on the use of technologies like screen printing that generate significant wastewater. Our printing process eliminates the need for separate pre-treatment, as well as steaming, washing or rinsing of textiles during the printing process, which leads to a significant reduction in water consumption compared to conventional printing methods. In addition, our inks are biodegradable and certified by leading industry groups as being safe for system operators, consumers and the environment. Finally, our systems offer energy saving processes that result in the use of significantly less power compared to traditional printing processes. We believe that these environmental benefits will further drive market penetration of our solutions and enable manufacturers to move production closer to the consumer in a cost-effective manner.

***Strong management team.*** Our Chief Executive Officer, Ronen Samuel, and our Chief Financial Officer, Guy Avidan, bring extensive experience of managing publicly traded companies and/or in management roles in the printing industry. Our management team's industry expertise and extensive experience in running global companies will enable us to execute our growth strategy. Our management infrastructure also includes executives who are experienced in the management of people, large scale business, innovation and product development in larger public organizations including Intel, HP, NICE, Amdocs and Stratasys. Over the past five years, we have also invested heavily in human resources to support our growth. Since 2013, our workforce has more than doubled from 190 to 444 as of December 31, 2018. Additionally, more than 167 of our employees are in the field, enabling us to provide more localized service to our customers.

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**Our Strategy and Catalysts for Growth**

The following are the key elements of our growth strategy and catalysts that will drive our business expansion:

***Remove market and technology barriers to drive continued organic growth.***

We are focused on ongoing investments in our research and development, product management, and applications development areas to continue driving innovation within the industry, thereby allowing our customers and prospects to grow their businesses by enabling them to expand their product offering with additional applications, designs, and fabric types. We focus on constantly removing barriers as they relate to quality, hand feel, and cost (as evidenced in the release of our latest HD family of solutions). We will continue to drive the productivity of our technology to allow existing and future customers to cost effectively obtain new jobs and transfer existing recurring jobs and impressions from analog to digital printing, which will drive increased sales of systems, consumables and services. As part of our strategy, we will continue to bring to the market solutions that enable efficient mass production and customization in a rapidly transforming industry that is shifting to shorter production runs and mass production of on-demand, at times one-by-one, orders. We believe that removing market barriers includes periodically introducing to the market innovative digital processes that address key industry pain points and gaps, which traditional analogue techniques cannot handle, do so with poor quality, or do so in a non-cost efficient manner. We believe that continuing to remove market and technology barriers and developing new features and functionality of our solutions will allow us to win new customers and increase system, consumables and services sales to existing customers.

***Enter Key Adjacent Markets.***

We plan to continue growing our customer base by targeting new customers in markets that are adjacent to the markets in which we have been operating. To date, we have been catering predominantly to the customized design market, consisting of online businesses of different sizes, focused mainly on mass customization and personalization that are enabled by using our technology. An example of our success in this market is the Master Purchase Agreement, that we entered into on January 10, 2017 with an affiliate of Amazon.com, Inc. To date we have supplied several systems, large quantities of inks and consumables and have been providing paid service to multiple facilities under the agreement. During the years 2017 and 2018, Amazon related revenues were $14.4 million and $24.2 million, respectively. We expect that our relationship with Amazon will continue to expand in the future and that they will remain a significant customer. We expect continued growth with other existing customers in the customized design market as they seek to grow capacity, provide new applications and expand into new market segments and geographies. We also expect to add new customers in the customized design market, as the market continues to grow and develop. With the breadth of our existing portfolio and our continued investment in features and functionality, we believe we are well positioned to expand our market reach by penetrating adjacent markets in the form of traditional and start-up brands, private labels, and the promotional market, in which we can drive adoption of digital DTG

printing solutions in place of analogue screen-printing production methods, which are currently primarily relied upon. While we have started to penetrate these markets, directly or via third-party fulfillers and decorators, we plan to deepen our penetration into these important markets as they seek to transform their business and operating models.

***Maximize system utilization by existing customers.***

We are focused on increasing sales to existing customers by introducing new digital printing applications, developing new features and functionality of our systems, offering new system upgrade products, increasing sales of software and value-added services, offering a customer empowerment program inclusive of basic and advanced training, with a goal of enabling our customers to increase utilization of their systems. We also intend to actively refer business to our customers by connecting them with online businesses that seek fulfillment partners, which will enhance customer intimacy. Our objective is to help customers operate their businesses more efficiently, print more impressions and increase utilization of their systems, thereby requiring more ink and other consumables purchases as well as potential investment in new systems as they require additional capacity.

***Expanding our GTM and services business.***

We continue to invest in our go-to-market infrastructure across geographies, including in our sales, applications, and services teams. While maintaining an overall hybrid go-to-market strategy that includes both indirect and direct sales, we have adopted a direct sales model in North America and are assessing moving towards that model in one or more additional key markets. In North America, we initiated the transition towards direct sales via our acquisition of the U.S.-based digital DTG printing assets of SPSI in 2016, in which we acquired an increasing number of larger accounts, which require a more direct relationship between our company and the related customers. We completed the transition in North America to a full direct sales model in February 2019, with our acquisition of customer business assets from Hirsch, our former primary distributor in the United States and Canada. By fostering direct sales relationships with our North American customers, we aim to deepen our relationship with them as well as better align our product roadmap to meet their needs.

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Strategic accounts are an important and valued part of our business and future growth, and we continue to make the appropriate investments in ensuring we serve their needs when it comes to sales, application consulting and services support. We expect to continue developing our strategic accounts practice in a combination of dedicated regional and corporate resources as we strive to help these important customers improve their business performances by delivering best-in-class customer experience.

We are seeking to increase the number of customers that rely on us to provide services for their systems by expanding our service capabilities and driving adoption of our portfolio of services contracts. As of December 31, 2018, we had service contracts in place with approximately 26% of our industrial and mass production installed base. Service revenues exceeded 10% of our overall revenues for the first time in 2017, and, in 2018, amounted to $16.6 million. In addition to driving gross margin improvement, we believe this will provide us an opportunity for direct contact with customers with the goal of reducing system down-time, educating customers about optimal use of our systems to drive increased utilization and growth in the number of impressions printed, expanding the variety of print applications and increasing sales of post-warranty service contracts and other professional application development services.

***Extend our leadership position through acquisitions and strategic partnerships.***

We seek to continue to differentiate ourselves and extend our leadership position. From time to time, we may supplement our internal efforts with complementary inorganic initiatives such as acquisitions and strategic partnerships to enhance our positioning. For example, our acquisition of Polymeric Imaging in 2015 expanded our ink technology capabilities, our acquisitions of the digital DTG printing assets of SPSI in 2016 enabled us to strengthen our direct sales channel and gain access to a large screen-printing customer base, and the acquisition of business assets from Hirsch in 2019 helped us transition to a full direct sales model in North America. Each of these acquisitions enhanced the positioning of our company. Future acquisitions may also allow us to strengthen our existing portfolio of solutions or add new capabilities.

**Our Products**

Our line of DTG systems offers a range of performance options depending on the needs of the customer. These options include the number and size of printing pallets, print engine, printing throughput and process ink colors, as well as other customizable features. We categorize our DTG systems into a few main category groups: Entry Level, Industrial, and Mass Production. We also intend to increase our portfolio in the near future with a specialty category. As our business and marketplace has evolved, we have shifted the mix of our system sales primarily to higher throughput systems:

***Entry Level DTG:*** We currently have one entry level system, our Breeze system. This system reduces the need for floor space for manufacturing equipment by eliminating certain process steps and by consolidating multiple process steps into a single printing system. The Breeze allows businesses to adopt digital technology with a limited upfront investment and use the same technology as our high throughput systems but with smaller garment printing areas and at lower throughput levels.

***Industrial DTG:*** We offer a wide range of industrial high throughput systems. Our mid-level platform, the Storm, which employs one axis of print heads and two pallets, consists of four models (Storm 2, Storm Hexa, Storm Duo and Storm 1000). Our next level of high throughput systems is based on the Avalanche platform which employs two print head axis with two pallets and comes in four different models (Avalanche, Avalanche DC, Avalanche 1000, Avalanche Hexa, Avalanche 1000R, Avalanche HexaR).

During 2017, we introduced a significant product improvement on the Avalanche platform in the form of the new R-Series systems. Incorporating a new print heads technology and ink delivery system architecture, we introduced an advanced system for ink waste management, thereby improving our customers profitability. The Avalanche 1000-R and the Avalanche Hexa-R systems replaced the former Avalanche 1000 and Avalanche Hexa systems respectively. In alignment with our products upgrade strategy an upgrade path from existing installed systems was also added to our product offering, allowing us to gain revenues from existing systems.

During 2018, we introduced our new HD technology into our industrial portfolio, based on a newly developed printing engine and ink-set. This new technology was specifically designed to achieve superior printing quality with lower ink laydown, resulting in lower cost-per-print and better overall cost of ownership to our customers. The HD technology is offered in the Storm platform in a hexa configuration (Storm HD6) and in the Avalanche platform in two configurations of hexa color and CMYK (Avalanche HD6 and Avalanche HDK). In alignment with our products upgrade strategy, an upgrade path from existing installed systems was also added to our product offering, enabling our customers to improve cost of ownership on their existing systems and allowing us to gain revenues from our existing installed base. The unique capabilities of the HD technology, in print quality and cost per print, and its availability on our two main industrial platforms, serve our strategy of screen-printing replacement, as it will allow us to penetrate screen printing accounts of different sizes and a variety of needs.

***Mass Production DTG:*** During 2016, we commercially launched our new high throughput platform, the Vulcan, which is geared towards addressing the needs of mass production at higher printing speeds and volumes and at a significantly lower cost per print. In the beginning of 2019, we launched our newest DTG platform – the Kornit Atlas. The Atlas represents our next generation direct-to-garment printing platform, equipped with our next generation HD technology and designed mainly for high-volume garment decoration businesses and mid-to-large size screen printers. With its retail-grade print quality, high productivity and attractive total cost of ownership, the Atlas will allow our customers to serve additional market needs and open new opportunities.

Our systems vary in throughput and productivity, applications of use, breadth of color gamut and cost per print. The underlying strategy behind our system lineup is to accommodate a variety of customer needs with a variety of capabilities and at a variety of price points. All of our DTG systems utilize our patented wet-on-wet printing methodology that involves spraying a wetting solution on the fabric before applying our proprietary pigment-based inks. This unique capability enables our systems to reach high throughput levels while still producing high quality images and designs. The wetting solution prevents the ink from bleeding into the textile and fixes the ink drops, which enables digital printing with high color-intensity and image sharpness. This methodology eliminates the common practice of separately coating and drying textiles prior to printing and allows for printing on a wide range of untreated fabrics.

***Direct-to-Fabric (DTF):*** Our Allegro system is the first DTF printing system to allow for one-step DTF printing. It combines a printing system and a drying and curing module so that a full end-to-end manufacturing process is enabled. Unlike the Allegro, most DTF printers require additional steps. The Allegro takes advantage of our patented wet-on-wet methodology to allow for in-line printing on various fabrics, without requiring a separate pre-treatment process, thereby avoiding the need to use textiles that are specifically pre-treated for digital printing. The Allegro is designed to achieve high throughputs and does not require water or steam for any part of the printing process, making it friendly to the environment. By using our proprietary pigment-based ink, Allegro can print on a variety of natural and synthetic fabrics providing customers with a significant level of flexibility. Most other dye-based systems are specifically designed to print on specific fabric types and cannot be used with other types of fabric as the processes and consumables used vary considerably from one to the other.

Our systems range in price from $69,000 to over $820,000 and consume an average of $5,000 to $300,000 of ink and consumables annually per system.

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**DTG Systems:**

The following table summarizes key aspects of our DTG systems, all of which are compatible with a wide range of fabrics, including cotton, wool, polyester, viscose, lycra and various blends, and print at maximum resolutions ranging from 600 to 1,200 DPI. Our systems are currently unable to print at a level of quality acceptable for large scale manufacturing on dyed polyester or nylon. However, we are in advanced stages of developing the capability to print on dyed polyester, giving us the opportunity to penetrate the lucrative athleisure market.

| System | Target Customer | Effective Throughput<br>Light/Dark Garments(1) | Colors | Max. Printing Area |
|---|---|---|---|---|
| **Breeze** | Entry Level | 32/25 | CMYK + White | 14 x 18 in |
| **Storm II** | High Throughput | 120/65 | CMYK + White | 20 x 28 in |
| **Storm 1000** | High Throughput | 170/85 | CMYK + White | 20 x 28 in |
| **Storm Hexa** | High Throughput | 170/85 | CMYKRG + White | 20 x 28 in |
| **Storm HD6** | High Throughput | 70/55(2) | CMYKRG + White | 20 x 28 in |
| **Storm Duo** | High Throughput | 190/N.A | CMYK + White | 20 x 28 in |
| **Avalanche** | High Throughput | 150/100 | CMYK + White | 23.5 x 35 in |
| **Avalanche DC Pro** | High Throughput | 150/100 | CMYK + White + Discharge ink | 23.5 x 35 in |
| **Avalanche 1000** | High Throughput | 220/160 | CMYK + White | 23.5 x 35 in |
| **Avalanche Hexa** | High Throughput | 180/140 | CMYKRG + White | 23.5 x 35 in |
| **Avalanche HDK** | High Throughput | 105/85(2) | CMYK + White | 23.5 x 35 in |
| **Avalanche HD6** | High Throughput | 105/85(2) | CMYKRG + White | 23.5 x 35 in |
| **Atlas** | High Throughput | 200/160(2) | CMYKRG + White | 23.5 x 35 in |
| **Paradigm II** | High Throughput | 120/120 | CMYK | 15.5 x 19.5 in |
| **Vulcan** | High Throughput | 250/250 | CMYKRG + White | 15.5 x 19.5 in |

*(1)* *Maximum output for sellable product for dark and light garments. Output for all systems, except the Vulcan, is measured in High Productivity print mode using A4 size prints per hour with pretreatment included. Output for the Vulcan system is measured in Standard print mode using 12 x 12 in size prints per hour with pretreatment included.*

*(2)* *Measurement method changed to 13"x13" image impression instead of A4.*

**Ink and Other Consumables**

Our ink and other consumables consist of our patented NeoPigment ink, proprietary binding agent, priming fluid, wiping fluid, and flushing fluid. Our pigment-based inks are available in seven colors and are formulated for optimal use exclusively in our systems. Our patented wet-on-wet printing methodology combines the use of pigments rather than dyes in conjunction with our proprietary binding agent and allows us to print on a wide range of fabrics without the need for a separate pre-treatment process or system reconfiguration, resulting in minimal setup times for each run and high throughput levels. Given the proprietary nature of our printing methodology, our ink and consumables attachment rate is close to 100%. We also continuously invest in the development of new ink formulas for our systems in order to expand the range of fabrics on which we can print, further increase the quality of our high-resolution images and designs and improve color fastness.

We have developed two patented methods for printing on dark or colored fabrics. The first method involves printing a layer of specially formulated white ink as a base upon which to print colored images and designs. Printing on top of this foundation enhances color intensity and creates contrast against the dark or colored fabric. In addition, we have developed a patented discharge ink for printing on dark or colored fabrics. The discharge ink bleaches the fabric dye and applies colored ink in the locations where the discharge ink removed the fabric dye. This method, which is primarily used by brand owners and contract printers, allows the printing of high-resolution images and designs without compromising the texture or feel of the garment.

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**Software Solutions**

Our DTG systems arrive with our QuickP Production software embedded. The software manages the system operation and prepares image files for print. QuickP Production is a simple to use solution that allows users to control key operating parameters, such as ink dots per inch, or DPI, perform maintenance and calibration procedures and import image files and prepare them for print.

Some of our customers also purchase our QuickP Designer software. QuickP Designer is a software package that combines our own internally developed Raster Image Processing, or RIP, software with other print job management capabilities and includes an advanced ink consumption estimation tool. A single QuickP Designer license can be used to support multiple Kornit systems.

In 2018 we introduced to market a new professional RIP software specifically designed in full collaboration with ColorGate. This new offering allows our customers to enhance our systems' performance in the areas of print quality and color management, allowing them to achieve superior results and manage high-end color demanding applications. The combination of this new product offering, together with our HD technology, also serves our screen-printing replacement strategy, allowing our customers to achieve color accuracy and matching to screen prints.

**Our Services**

Our services consist of maintenance and support, and professional services. We are seeking to increase the number of customers that rely on us to provide services for their systems by expanding our service capabilities. As of December 31, 2018, we had service contracts in place with approximately 26% of our industrial and mass production installed base. Service revenues exceeded 10% of our overall revenues for the first time in 2017 and, in 2018, amounted to $16.6 million. In addition to driving gross margin improvement, we believe this will provide us an opportunity for direct contact with customers with the goal of reducing system down-time, educating customers about optimal use of our systems to drive increased utilization, expanding the variety of print applications and increasing sales of post-warranty service contracts and other professional application development services.

**Maintenance and Support**

During 2018, we provided a 12-month warranty on our systems, which covers parts, labor and remote support. Our customers can also purchase an additional year of service and support coverage in conjunction with their initial

purchase of our systems. Thereafter, customers can renew maintenance and support contracts for additional periods by purchasing a maintenance and support package that covers remote support, maintenance, software release and onsite yearly maintenance, or they can choose to rely on our support on a non-contractual time and materials basis. In the United States, we provide maintenance and support directly to our customers. In the EMEA region, we provide maintenance and support to approximately half of our customers, depending on their location. In the Asia Pacific region, our independent distributors provide initial maintenance and support, and we provide second-line support when needed.

**Professional Services**

Our systems are designed such that customers can operate them without the assistance of our company or our independent distributors. However, nearly all customers purchase our basic installation package and some take our advanced training program. Our advanced training program is an onsite tutorial ranging from three to five days, which includes customized consulting aimed at optimizing the use of our systems. Courses are also provided at our regional offices. We continuously seek to expand the number and content of the training programs. We recently launched our Customer Empowerment Plan that emphasizes knowledge-transfer to our customers. We have furthermore established three training centers at our regional offices that are aimed at familiarizing customers with their systems by obtaining access to online training and documentation, and by getting to know important operation, maintenance and application procedures by attending technical and application training in our training center. We provide professional services to customers in all regions, both in person and through advanced web-based learning systems.

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**Our Customers**

Our diverse global customer base consisted of more than 1,200 customers as of December 31, 2018. Throughout our growing installed base, our customers can serve a variety of different business models, particularly the new business models that have developed in response to the evolution of consumer trends and the rapid growth of the online retail market. Our solutions enable this category of "web-to-print" businesses to fulfill consumer demand more quickly and cost-effectively in a manner that is differentiated from traditional brick and mortar businesses. A number of large-scale, web-to-print platforms have emerged. These platforms often leverage digital printing solutions to facilitate business for other content providers.

The ecosystem of web-to-print businesses that we currently serve includes:

*Self-Fulfillment*. Companies manufacturing and selling their own designs that are advertised on their own websites and through other marketing means.

*Hybrid Printers*. Companies that both manufacture in-house and outsource manufacturing to third party fulfillment providers, who are often also our customers.

*Third Party Fulfillment Centers*. Companies serving as third party fulfillment for other businesses. Third party fulfillment providers include a number of our customers. Demand for these businesses is typically generated online through other web retailers.

Proximity to the end customer is a key factor for these businesses since it minimizes shipping costs and enables them to offer rapid turnaround to consumers, which is a key factor in choosing where to buy online apparel. In many cases, retailers have asked us for assistance in identifying our local customers to help with their fulfillment.

See "ITEM 10.D - Material Contracts - Agreements with Amazon."

**C. Organizational Structure**

Our corporate structure consists of Kornit Digital Ltd., our Israeli parent company, and five wholly-owned subsidiaries: (1) Kornit Digital Technologies Ltd., which was incorporated on July 5, 2006 under the laws of the State of Israel, (2) Kornit Digital North America Inc., which was incorporated on September 12, 2007 under the laws of the State of Delaware, (3) Kornit Digital Europe GmbH, which was incorporated on April 20, 2011 under the laws of Germany, (4) Kornit Digital Asia Pacific Limited, which was incorporated on November 18, 2009 under the laws of Hong Kong, and (5) Kornit Digital UK Ltd., which was incorporated on August 30, 2017 under the laws of England and Wales.

**D. Property, Plant and Equipment**

Our corporate headquarters are located in Rosh Ha'Ayin, Israel in an office and research and development facility consisting of approximately 83,000 square feet. The lease for this office expires in December 2020, with an option to extend the lease for an additional five years. We lease an additional facility of approximately 8,000 square feet near our corporate headquarters. The lease for this additional space expires in December 2020, with an option to extend the lease for an additional 18 months. In Israel, we also lease a manufacturing facility in Kiryat Gat, which consists of approximately 19,000 square feet. The lease for the Kiryat Gat manufacturing facility expires on May 31, 2021, and we have an option to lease this facility for an additional three years. We can terminate this lease by providing 180 days' prior notice. The current utilization of the total production capacity at this facility would allow us to more than double our current output at the facility by increasing the number of shifts on the existing production lines by hiring additional manufacturing personnel and without requiring us to expand the physical structure of the facility. We have secured a location for a new, modern, manufacturing facility that we intend to build in Kiryat Gat with the goal of increasing operational efficiency and providing for improved safety and security. Construction has begun in January 2019 and is expected to be completed by 2021. We currently expect to incur capital expenditures for the new facility in order to complete the acquisition of the property and building of this facility.

Our new U.S. headquarters are located in Englewood, New Jersey. We have entered into a lease for these headquarters, which are comprised of approximately 15,845 square feet of offices and warehouse. The lease for this location expires in February 2028. We also maintain a smaller office in Mequon, Wisconsin, which was the location of our U.S. headquarters prior to their relocation to New Jersey. We maintain additional sales, support and marketing offices in Dusseldorf, Hong Kong and Shanghai.

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**ITEM 4A. Unresolved Staff Comments.**

None.

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

*The information contained in this section should be read in conjunction with our financial statements for the year ended December 31, 2018 and related notes and the information contained elsewhere in this annual report. Our financial statements have been prepared in accordance with U.S. GAAP. This discussion contains forward-looking statements that are subject to known and unknown risks and uncertainties. As a result of many factors, such as those set forth under "ITEM 3.D. Risk Factors" and "Cautionary Note Regarding Forward-Looking Statements," our actual results may differ materially from those anticipated in these forward-looking statements.*

**Overview**

We develop, design and market innovative digital printing solutions for the global printed textile industry. Our vision is to revolutionize this industry by facilitating the transition from analog processes that have not evolved for decades to digital methods of production that address contemporary supply, demand and environmental dynamics. We focus on the rapidly growing high throughput DTG and DTF segments of the printed textile industry. Our solutions include our proprietary digital printing systems, ink and other consumables, associated software and value-added services that allow for large scale printing of short runs of complex images and designs directly on finished garments and fabrics.

We have developed and offer a broad portfolio of differentiated digital printing solutions for the DTG market that provide answers to challenges faced by participants in the global printed textile industry. Our DTG solutions utilize our patented wet-on-wet printing methodology that eliminates the common practice of separately coating and drying textiles prior to printing. This methodology also enables printing on a wide range of untreated fabrics, including cotton, wool, polyester, lycra and denim. Our patented NeoPigment ink and other consumables have been specially formulated to be compatible with our systems and overcome the quality-related challenges that pigment-based inks have traditionally faced when used in digital printing. Our software solutions simplify workflows in the printing process, by offering a complete solution from web order intake through graphic job preparation and execution.

Building on the expertise and capabilities we have accumulated in developing and offering differentiated solutions for the DTG market, we market a digital printing solution, the Allegro, targeting the DTF market. While the DTG market generally involves printing on finished garments, the DTF market is focused on printing on fabrics that are subsequently converted into finished garments, home or office décor and other items. The Allegro utilizes our

proprietary wet-on-wet printing methodology and houses an integrated drying and curing system. We primarily market the Allegro to web-based businesses that require a high degree of variety and limited quantity orders, as well as to fabric converters, which source large quantities of fabric and convert untreated fabrics into finished materials to be sold to garment and home décor manufacturers. We believe that with the Allegro we are well positioned to take advantage of the growing trend towards customized home décor. We began selling the Allegro commercially in the second quarter of 2015.

Our go to market strategy consists of a hybrid model of indirect and direct sales, with a trend towards adopting a direct sales model in certain key markets, as we have done in North America. We have historically generated a significant portion of our sales through a global network of independent distributors and value added resellers that we refer to as our channel partners. Our channel partners, in turn, sell the solutions they purchase from us to customers for whom we provide installation services, or sell and install our solutions on their own. Our channel partners work closely with our sales force and assist us by identifying potential sales targets, closing new business and maintaining relationships with and, in certain jurisdictions, providing support directly to our customers. Our agreement with our previous primary independent distributor in North America has terminated effective as of February 7, 2019. We expect that we may experience an initial disruption to our sales efforts in that region as we transition from our previous sales structure to a direct sales model. In addition, a shift to a direct sales model may result in a short-term adverse impact on our results of operations.

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Maintenance and support for our systems is performed either by our own service organization or by service engineers employed by our distributors. This varies among the four regions that we currently serve, depending on the infrastructure we have established in each particular region. We provide professional services directly to some of our customers in all regions. Our customers can renew maintenance and support contracts for additional periods by purchasing a maintenance and support package that covers remote support, software upgrades and onsite yearly maintenance or they can choose to rely on our support on a non-contractual time and material basis.

We have an attractive business model that results in recurring sales of ink and other consumables driven by our growing installed base of systems. Our ink and other consumables are specially formulated to enable our systems to operate at the highest throughput level while adhering to high print quality requirements.

We intend to capitalize on the continued growth of the DTG market by expanding our diverse global customer base, with particular focus on the fast-growing web-to-print businesses. We also seek to increase our sales to existing customers, particularly sales of our ink and other consumables. At the same time, we look to acquire new high-volume customers, which drives higher sales of ink and other consumables. We are also seeking to extend our serviceable addressable market by introducing new features and functionality that enhance the capabilities of our systems and inks, and enable our systems to print on new types of media. We plan to accomplish these goals by investing in our direct sales force, developing new applications for our systems, introducing new solutions and growing our relationships with channel partners.

We were founded in 2002 in Israel and shipped our first system in 2005. As of December 31, 2018, we had 444 employees located across four regions: Israel, America, Europe and the Asia Pacific region.

## A. Operating Results

*The information contained in this section should be read in conjunction with our audited financial statements for the years ended December 31, 2016, 2017 and 2018 and related notes and the information contained in ITEM 18. Financial Statements. Our financial statements have been prepared in accordance with GAAP.*

### Components of Statement of Operations

***Revenues***

*Systems, Ink and Other Consumables, Value Added Services*

Substantially all of our revenues are generated from sales of our systems and ink and other consumables. Prior to 2017, we derived, and in the near term we expect to continue to derive, a majority of our revenues from sales of our systems. However, in 2017, due to lower systems sales which resulted in large part from the delay in receipt of permits for a new site for one of our large customers in the United States, we derived a larger portion of our revenues from sales of ink and consumables. In the medium term, we are targeting an equal mix of revenues from our systems compared to ink and other consumables. We do not consider the period to period change in our total installed base to be a helpful metric in assessing our performance because we currently sell a number of different systems that have significantly different throughput characteristics and average selling prices. Accordingly, since we have not experienced material changes in the prices at which we sell ink and other consumables, we believe the best measure of the success of our strategy is the amount of the increase in revenues from ink and other consumables that is generated in each period.

We generate the services portion of our revenues from the provision of spare parts to our distributors and customers, post-warranty service contracts, value added services consisting of time and material based support and system upgrades.

We have historically sold our products directly and through independent distributors who resell them to customers. Sales by our distributors accounted for approximately 49% and 44% of our revenues during 2017 and 2018, respectively. On July 1, 2016, we completed the acquisition of the DTG assets of one of our distributors in the United States, which increased our direct sales during 2016. On February 7, 2019, our agreement with our previous primary independent distributor in North America, which accounted for 18% and 15% of our revenues in the years ended December 31, 2017 and 2018, respectively, terminated. Despite our transition to a direct sales model in North America, we continue to generate a small, non-material portion of our revenues from the distribution of our products in North America via certain independent distributors.

We recognize revenues in accordance with ASC No. 606, "Revenue from Contracts with Customers". As such, we recognize revenue under the core principle that transfer of control to our customers should be depicted in an amount reflecting the consideration we expect to receive in revenue. Therefore, we identify a contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to each performance obligation in the contract and recognize revenues when, or as, we satisfy a performance obligation.

We periodically provide customer incentive programs including product discounts, volume-based rebates and warrants, which are accounted for as variable consideration which is deducted from revenue in the period in which the revenue is recognized. These reductions to revenue are made based upon reasonable and reliable estimates that are determined by historical experience and the specific terms and conditions of the incentive

See "—Critical Accounting Policies—Revenue Recognition".

*Geographic Breakdown of Revenues*

The following table sets forth the geographic breakdown of revenues from sales to customers located in the regions indicated below for the periods indicated:

| | 2016 | | 2017 | | 2018 | |
|---|---|---|---|---|---|---|
| | $ | % | $ | % | $ | % |
| | (in thousands except percentages) | | | | | |
| U.S. | $63,656 | 58.6 % | $60,541 | 53.1 % | $77,652 | 54.5 % |
| EMEA | 24,720 | 22.7 | 32,015 | 28.1 | 45,195 | 31.7 |
| Asia Pacific | 11,963 | 11.0 | 16,092 | 14.1 | 15,572 | 10.9 |
| Other | 8,355 | 7.7 | 5,440 | 4.7 | 3,954 | 2.9 |
| Total revenues | $108,694 | 100.0% | $114,088 | 100.0% | $142,373 | 100.0% |

***Shipping and handling***

Shipping and handling fees that are charged to our customers are recognized as revenue in the period shipped and the related costs for providing these services are recorded as a cost of revenues.

***Cost of Revenues and Gross Profit***

Cost of revenues consists primarily of payments to the third-party contract manufacturers who assemble our systems and who are responsible for ordering most of the components for those systems. Cost of revenues also includes components for our systems for which we are responsible, such as print heads, as well as raw materials for ink and other consumables. Cost of revenues includes personnel expenses, such as operation and supply chain employees, and related overhead for the manufacturing of our systems, as well as expenses for service personnel involved in the installation and support of our systems, shipping and handling fees and overhead for the manufacturing process of ink and other consumables. For 2016, cost of revenues also included the difference between the higher carrying cost of the acquired inventory from a distributor purchased on July 1, 2016 which was recorded at fair value. We expect cost of revenues to increase in absolute dollars due to increased revenues but remain relatively constant or decrease as a percentage of total revenues, as we continue to improve our manufacturing processes and supply chain and as the costs related to our service infrastructure, which have a fixed component, are leveraged across a larger installed base.

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Gross profit is revenues less cost of revenues. Gross margin is gross profit expressed as a percentage of total revenues. Our gross margin has historically fluctuated from period to period as a result of changes in the mix of the systems that we sell and the amount of revenues that we derive from ink and other consumables versus systems. In general, we generate higher gross margins from our high throughput systems compared to entry level systems. In addition, customers that purchase our high throughput systems generally use larger quantities of ink and other consumables, which generate higher margins than sales of systems. We expect that gross margins will increase due to improvements in economies of scale and improvements in services gross margin.

We currently provide maintenance and support for all of our systems sold in the United States even if the sale is made through a distributor. We are seeking to increase the number of customers that rely on us to provide maintenance and support for their systems by expanding our maintenance and support capabilities. In addition to driving gross margin improvement, we believe this will provide an opportunity for direct contact with customers with the goal of reducing system down-time, educating customers about optimal use of our systems to drive increased utilization, expanding the variety of print applications and increasing sales of post-warranty service contracts and other professional application development services. Our service operations have not been profitable on a stand-alone basis. We are seeking to generate greater revenues from our service offering, and thereby leverage the fixed cost component associated with it, by increasing sales of post-warranty service contracts, selling upgrade kits and providing other professional services.

***Operating Expenses***

Our operating expenses are classified into four categories: research and development expenses, sales and marketing expenses, general and administrative expenses and restructuring expenses. For each category, the largest component is generally personnel costs, consisting of salaries and related personnel expenses, including share-based compensation expenses. Operating expenses also include allocated overhead costs for facilities, including rent payments under our facility leases. We expect personnel and allocated costs to continue to increase at a controlled pace as we hire new employees to support growth of our business, but at a slower pace than in prior years. In the long term, we expect operating expenses to decrease as a percentage of revenues.

*Research and Development Expenses.* The largest component of our research and development expenses is salaries and related personnel expenses for our research and development employees. Research and development expenses also include purchases of laboratory supplies; expenses related to beta testing of our systems; and allocated overhead costs for facilities, including rent payments under our facilities leases. We record all research and development expenses as they are incurred. We expect research and development expenses to slightly increase in absolute terms as we continue to hire additional personnel for the development of upgrades to existing systems and additional systems that we develop. Our current research and development efforts are primarily focused on our next generation of DTF and DTG systems. We are also investing in the development of new ink formulas for our new systems and in order to expand the range of fabrics on which we can print and further improve color quality and diversification of our high-resolution images and designs.

*Sales and Marketing Expenses.* The largest component of our sales and marketing expenses is salaries and related personnel expenses for our marketing, sales and other sales-support employees. Sales and marketing expenses also include trade shows, other advertising and promotions, including distributor open houses and media advertising; sales-based commissions and allocated overhead costs for facilities, including rent payments under our facilities leases. We market our solutions using a combination of internal marketing professionals and our network of channel partners. We expect sales and marketing expenses to continue to increase in absolute terms in the near term as we add sales and marketing personnel, including pursuant to our direct product distribution strategy in certain key markets.

*General and Administrative Expenses.* The largest component of our general and administrative expenses is salaries and related personnel expenses for our executive officers, financial staff, information technology staff, and human resources staff. General and administrative costs also include fees for accounting and legal services and allocated overhead costs for facilities, including rent payments under our facilities leases. We expect our general and administrative expenses to increase in absolute terms in the near term, but at a slower pace than in prior years, as a result of additional personnel to support our growth and the relocation of our U.S. headquarters from Mequon, Wisconsin to Englewood, New Jersey.

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***Finance Income, Net***

Finance income, net consists of interest income and foreign currency exchange gains or losses. Foreign currency exchange changes reflect gains or losses related to changes in the value of our non-U.S. dollar denominated financial assets, primarily cash and cash equivalents, and trade payables and receivables. As of December 31, 2018, we did not have any indebtedness for borrowed amounts. Interest income consists of interest earned on our cash, cash equivalents, short-term bank deposits and marketable securities, offset by amortization of premium on marketable securities. We expect interest income to vary depending on our average investment balances and market interest rates during each reporting period.

***Taxes on Income***

The corporate tax rate in Israel was 25% in 2016 and 24% in 2017 and was reduced to 23% for 2018 and all subsequent years. However, as discussed in greater detail below under "Taxation and Israeli Government Programs Applicable To Our Company — Israeli Tax Considerations and Government Programs," we and our wholly-owned Israeli subsidiary Kornit Technologies, are entitled to various tax benefits under the Israeli Law for the Encouragement of Capital Investments, 1959, or the Investment Law.

Starting from January 1, 2014, we consolidate the results of our Israeli operations for tax purposes such that net operating loss carryforwards of Kornit Technologies generated from 2014 onwards can be used to offset Israeli taxable income from us. Kornit Technologies currently generates sufficient net operating loss carryforwards to offset the taxable income of the parent. Accordingly, we were not subject to income tax in Israel in 2016, 2017 or 2018 and our effective tax rate was the blended rate of our Israeli tax and those of our non-Israeli subsidiaries in their respective jurisdictions of organization.

Under the Investment Law and other Israeli legislation, we are entitled to certain additional tax benefits, including accelerated depreciation and amortization rates for tax purposes on certain assets, deduction of public offering expenses in three equal annual installments and amortization of other intangible property rights for tax purposes.

**Comparison of Period to Period Results of Operations**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2017 | 2018 |

| | (in thousands) | | |
|---|---|---|---|
| Revenues | | | |
| Products | $100,818 | $101,953 | $125,729 |
| Services | 7,876 | 12,135 | 16,644 |
| Total revenues | 108,694 | 114,088 | 142,373 |
| Cost of revenues | | | |
| Products | 46,483 | 46,480 | 53,303 |
| Services | 12,801 | 13,497 | 19,201 |
| Total cost of revenues | 59,284 | 59,977 | 72,504 |
| Gross profit | 49,410 | 54,111 | 69,869 |
| Operating expenses: | | | |
| Research and development | 17,383 | 20,834 | 21,912 |
| Sales and marketing | 18,338 | 21,279 | 25,596 |
| General and administrative | 12,259 | 13,578 | 16,436 |
| Restructuring expenses | - | 503 | 321 |
| Total operating expenses | 47,980 | 56,194 | 64,265 |
| Operating income (loss) | 1,430 | (2,083 ) | 5,604 |
| Finance income, net | 46 | 452 | 1,433 |
| Income (loss) before taxes on income (tax benefit) | 1,476 | (1,631 ) | 7,037 |
| Taxes on income (tax benefit) | 648 | 384 | (5,392 ) |
| Net income (loss) | $828 | $(2,015 ) | $12,429 |

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| | Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2017 | 2018 |
| | (as a % of revenues) | | |
| Revenues | | | |
| Products | 92.8% | 89.4% | 88.3% |
| Services | 7.2 | 10.6 | 11.7 |
| Total revenues | 100 | 100 | 100 |
| Cost of revenues | | | |
| Products | 42.7 | 40.8 | 37.4 |
| Services | 11.8 | 11.8 | 13.5 |
| Total cost of revenues | 54.5 | 52.6 | 50.9 |
| Gross profit | 45.5 | 47.4 | 49.1 |
| Operating expenses: | | | |
| Research and development | 16.0 | 18.3 | 15.4 |
| Sales and marketing | 16.9 | 18.7 | 18.0 |
| General and administrative | 11.2 | 11.9 | 11.5 |
| Restructuring expenses | - | 0.4 | 0.2 |
| Total operating expenses | 44.1 | 49.3 | 45.1 |
| Operating income (loss) | 1.3 | (1.8 ) | 3.9 |
| Finance income, net | 0.0 | 0.4 | 1 |
| Income (loss) before taxes on income (tax benefit) | 1.4 | (1.4 ) | 4.9 |
| Taxes on income (tax benefit) | 0.6 | 0.3 | (3.8 ) |
| Net income (loss) | 0.8 % | (1.8 )% | 8.7 % |

***Comparison of the Years Ended December 31, 2017 and 2018***

*Revenues*

Revenues increased by $28.3 million, or 24.8%, to $142.4 million in 2018 from $114.1 million in 2017, which is net of $4.6 million and $2.9 million, in 2018 and 2017, respectively, in fair value of the warrants associated with revenues recognized from Amazon. The growth in revenues resulted from a 16.4% increase in ink and other consumables revenues to $59.9 million in 2018 from $51.5 million in 2017, a 37.2% increase in service revenues to $16.6 million in 2018 from $12.1 million in 2017, and an increase of 30.4% in systems revenues from $50.5 million in 2017 to $65.8 million in 2018. The $8.4 million increase in ink and other consumables revenues was due to higher sales volumes of ink and other consumables and our larger installed base. The $15.3 million increase in systems revenues was particularly attributable to the launch of HD systems and upgrades. The increase in our services revenues was primarily due to an increase in sales of spare parts and service contracts to our installed base as well as an increase in systems upgrades.

*Cost of Revenues and Gross Profit*

Cost of revenues increased by $12.5 million, or 20.9%, to $72.5 million in 2018 from $60.0 million in 2017. Gross profit increased by $15.8 million, or 29.1%, to $69.9 million in 2018 from $54.1 million in 2017. Gross margin was 49.1% in 2018, compared to 47.4% in 2017. Gross margin increased as a result of the shift in mix of system revenues in favor of high throughput industrial systems, which have a relatively higher gross margin percentage, and due to a decrease in inventory write offs by $1.2 million compared to 2017. The increase in gross profit was also due to economies of scale in our operations, partially offset by lower services gross margin, which resulted from an increase in labor costs due to our more widely dispersed install base.

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*Operating Expenses*

| | Year Ended December 31, 2017 | | 2018 | | Ch |
|---|---|---|---|---|---|
| | Amount | % of Revenues | Amount | % of Revenues | An |
| | | | ($ in thousands) | | |
| Operating expenses: | | | | | |
| Research and development | $20,834 | 18.3% | $21,912 | 15.4% | $1 |
| Sales and marketing | 21,279 | 18.7 | 25,596 | 18.0 | 4 |
| General and administrative | 13,578 | 11.9 | 16,436 | 11.5 | 2 |
| Restructuring expenses | 503 | | | | |

Potential Payments Upon Termination and Change in Control

The following table summarizes the value of the termination payments and benefits that our named executive officers would receive if they had been Involuntarily Terminated (as defined in their respective employment agreements), or resigned following a Change in Control, as described below, on December 31, 2008. This table excludes vested account balances under our 401(k) plan that is generally available to all of our employees:

Severance Payments for Involuntary Termination
December 31, 2008

| Name | Aggregate Severance Pay ($) | Restricted Stock ($) (1) | Stock Options ($) (1) | Welfare Benefits Continuation ($) (2) | Total ($) |
|---|---|---|---|---|---|
| David F. Carney | 1,607,959 | 159,000 | 21,499 | 27,233 | 1,815,691 |
| Shaun E. McAlmont | 828,373 | 662,500 | 17,200 | 25,375 | 1,533,448 |
| Scott M. Shaw | 823,955 | 662,500 | 12,900 | 25,333 | 1,524,688 |
| Cesar Ribeiro | 797,669 | 662,500 | 21,499 | 26,152 | 1,507,820 |

(1) Upon a Change in Control, all outstanding stock options granted and restricted stock awarded by us or any of our affiliates to our named executive officers will become fully vested and

immediately exercisable on the date of the Change in Control. The named executive officers would not receive the amounts designated under the "Aggregate Severance Pay" and "Welfare Benefits Continuation" columns.

(2) Includes the employer portion of the premiums necessary to continue health care coverage and the value of the continued use of an automobile and payment of associated costs by us for one year from the date of termination.

Change In Control. As discussed above under "Employment-Related Arrangements", upon a Change in Control (as defined in our named executive officers employment agreements), we (or our successor) will continue the employment of our named executive officers, and they will continue performing services for us for a period of two years commencing on the date of the Change in Control and ending on the second anniversary thereof. Upon a Change in Control, all outstanding stock options granted and restricted stock awarded by us or any of our affiliates to our named executive officers will become fully vested and immediately exercisable on the date of the Change in Control.

During a 30-day period commencing on the first anniversary of the date of the Change in Control, each of our named executive officers will have the right to resign from their employment with us (or our successor) for any reason and receive an amount equal to (i) one times the amount of their base salary, as is then in effect, and (ii) one times the average of their annual bonus paid to him for the two years immediately prior to the year in which such resignation occurs. If, however, such resignation constitutes an Involuntary Termination (as defined below), our named executive officers will receive payments in accordance with an Involuntary Termination.

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Employment-Related Arrangements

The employment agreements for each of our named executive officers were amended on January 14, 2009. The descriptions of the employment agreements below reflect these amendments.

Employment Agreement with David F. Carney

Employment Period. The agreement provides that Mr. Carney will serve as our Chairman and Chief Executive Officer through April 29, 2009 and as Executive Chairman from April 30, 2009 through December 31, 2010.

Compensation and Benefits. We have agreed that we will compensate Mr. Carney with a minimum annual base salary of $425,000. Mr. Carney will also be eligible to earn an annual bonus for each calendar year during the term of his employment, pursuant to the terms of our MIC Plan in effect for such calendar year. For a description of the MIC Plan, please see page 10.

Mr. Carney will also be included, to the extent eligible, in all of our employee benefit plans, programs and arrangements (including, without limitation, any plans, programs or arrangements providing for retirement benefits, profit sharing, disability benefits, health and life insurance or vacation and paid holidays) that are established for, or made available to, our senior executives. In addition, we will furnish Mr. Carney with coverage by our customary director and officer indemnification arrangements, subject to applicable law.

Involuntary Termination. In the event that during Mr. Carney's employment term, there is an "Involuntary Termination" (as defined below) of Mr. Carney's employment, we will pay him: (1) two times the amount of his base salary, as is then in effect; (2) two times the average of his annual bonus; (3) all outstanding reasonable travel and other business expenses incurred as of the date of his termination; and (4) the employer portion of the premiums necessary to continue his health care coverage for the earlier of (A) one year and (B) the date on which he is covered under another group health plan. Mr. Carney will also be entitled to (1) the continued use of an automobile and payment of associated costs by us for the greater of (A) one year and (B) the remainder of his employment term and (2) receive any other accrued compensation and benefits otherwise payable to him as of the date of his termination. All the aforementioned payments would be paid by us in a lump-sum amount no later than 30 days after the date of his termination. This lump sum payment may be deferred for six months, if necessary, to comply with the American Jobs Creation Act of 2004. For purposes of Mr. Carney's employment agreement, "Involuntary Termination" means the termination of his employment (1) by us (or any successor thereto) without "Cause" (as defined in his employment

agreement) or (2) by Mr. Carney for "Good Reason" (as defined in his employment agreement).

Termination for Cause, Death or Disability; Resignation Other than for Good Reason. In the event that during Mr. Carney's employment term, Mr. Carney's employment is terminated by us for Cause, or Mr. Carney resigns from his employment other than for Good Reason, we will pay him (or his estate, if applicable) his accrued but unpaid base salary earned through the date of termination, unreimbursed expenses, plus any other accrued but unpaid employee benefits earned through the date of his termination, including, without limitation, any annual bonus due but not yet paid for a completed calendar year.

Change in Control. Upon a Change in Control (as defined in his employment agreement), we (or our successor) will continue the employment of Mr. Carney, and Mr. Carney will continue performing services for us for a period of two years commencing on the date of the Change in Control and ending on the second anniversary thereof. Upon a Change in Control, all outstanding stock options granted and restricted stock awarded by us or any of our affiliates to Mr. Carney will become fully vested and immediately exercisable on the date of the Change in Control.

During a 30-day period commencing on the first anniversary of the date of the Change in Control, Mr. Carney will have the right to resign from his employment with us (or our successor) for any reason and receive an amount equal to (i) one times the amount of his base salary, as is then in effect, and (ii) one times the average of his annual bonus paid to him for the two years immediately prior to the year in which such resignation occurs. If, however, such resignation constitutes an Involuntary Termination (as defined above), he will receive payments in accordance with an Involuntary Termination. All of the aforementioned payments would be paid by us in a lump-sum amount no later than 30 days after the date of his termination.

Reduction in Payments. The employment agreement contains an Internal Revenue Code, as amended (the "Code") Section 280G "cusp" provision. In the event that any payment or distribution by us to or for the benefit of Mr. Carney pursuant to the terms of the employment agreement or otherwise would be considered a "parachute payment" and the amount of the parachute payment, after deduction of all relevant taxes, including excise taxes imposed by Code Section 4999, is less than the amount Mr. Carney would receive if he was paid three times his average "base amount" less $1.00, then the aggregate amounts constituting the parachute payment will be reduced (or returned by Mr. Carney if already paid to him) to an amount that will equal three times his average "base amount" less $1.00.

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Noncompetition. Mr. Carney is subject to a noncompetition restrictive covenant during the term of his employment and for one year thereafter, although the covenant will not apply if his employment is terminated due to an Involuntary Termination or he resigns during the 30-day period commencing on the first anniversary of a Change in Control.

Nonsolicitation. Mr. Carney is subject to a nonsolicitation restrictive covenant of clients, employees and key consultants during the term of this employment and for one year thereafter.

Confidentiality. Mr. Carney is subject to a confidentiality restrictive covenant of unlimited duration.

Arbitration. Any dispute or controversy arising under or in connection with Mr. Carney’s employment agreement that cannot be mutually resolved by him and us will be settled exclusively by arbitration in West Orange, New Jersey. The cost of the arbitration will be borne by the parties in the manner determined by the arbitrators.

Waiver and Release. Our obligations under Mr. Carney’s employment agreement are subject to Mr. Carney executing and delivering a waiver and release (relating to his release of claims against us) in a form reasonably and mutually agreed upon.

Employment Agreements with Named Executive Officers other than Mr. Carney

The terms of the Company’s employment agreements for Messrs. McAlmont, Shaw and Ribeiro are identical to those set forth in Mr. Carney’s employment agreement described above, except that (a) Mr. McAlmont will serve as President and Chief Operating Officer through April 29, 2009 and as President and Chief Executive Officer from April 30, 2009 through December 31, 2010 and will receive a minimum annual base salary of $375,000; (b) Mr. Shaw will serve as Executive Vice President and Chief Administrative Officer and will receive a minimum annual base salary of $325,000; (c) Mr. Ribeiro will serve as Senior Vice President, Chief Financial Officer and Treasurer, and will receive a minimum annual base salary of $315,000; and (d) in the event of an Involuntary Termination of either of Messrs. McAlmont’s, Shaw’s or Ribeiro’s employment term, each shall only be entitled to receive a payment of one and one half times his base salary and average annual bonus.

Director Compensation

As described more fully below, this chart summarizes the annual cash compensation for the Company’s non-employee directors during 2008:

Director Compensation
for Fiscal Year End December 31, 2008 (1)

| Name | Fees Earned or Paid in Cash ($) | Stock Awards ($) (2) | Total ($) |
|---|---|---|---|
| Peter S. Burgess | 47,500 | 43,711 | 91,211 |
| James J. Burke, Jr. | 38,000 | 43,711 | 81,711 |
| Celia H. Currin | 36,000 | 52,219 | 88,219 |
| Paul E. Glaske | 35,000 | 43,711 | 78,711 |
| Charles F. Kalmbach | 16,500 | 6,667 | 23,167 |
| Alexis P. Michas | 37,000 | 43,711 | 80,711 |
| J. Barry Morrow | 33,000 | 52,219 | 85,219 |
| Jerry G. Rubenstein | 34,000 | 43,711 | 77,711 |

(1) David F. Carney does not receive any fees or stock awards for his service as a director.

(2) Represents the compensation costs for financial reporting purposes for the year under FAS 123R.

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Compensation of Directors

The Company currently pays each of its non-employee directors annual compensation of $25,000 for services to the Company. In addition, each non-employee director receives $1,000 per board meeting attended in person or by telephone. The chairman of each committee of the board receives an additional $500 per board meeting attended. Non-employee directors on committees of the board will each receive an additional payment of $1,000 for each committee meeting attended on a day other than the day of a board meeting for which that director has been compensated. The audit committee chairman will receive an additional $10,000 annual retainer.

Non-employee directors are also eligible to receive awards of restricted stock under the 2005 Non-Employee Directors Restricted Stock Plan (the Restricted Stock Plan) as compensation for their services as directors.

Initial Grant of Restricted Stock. Pursuant to the Restricted Stock Plan, each non-employee director receives an initial award of shares of restricted stock equal to $60,000 (based on the Fair Market Value of a share of Common Stock on the Date of Grant) for service as a director of the Company on the first day of the calendar month following the month in which such non-employee director becomes a non-employee director.

Annual Grants of Restricted Stock. The Restricted Stock Plan also provides that, as of the date of each annual meeting, each non-employee director shall automatically receive an award of shares of restricted stock equal to $40,000 (based on the Fair Market Value of a share of Common Stock on the Date of Grant) for service as a director of the Company, provided that such non-employee director shall continue to serve as a director of the Company immediately after such annual meeting. On May 2, 2008, 3,355 shares of common stock were awarded to each of our seven non-employee directors. The per share fair market value of the common stock on May 2, 2008 was $11.92. On September 1, 2008, 3,992 shares were awarded to Director Kalmbach. The per share fair market value of the common stock on September 1, 2008 was $15.03.

All awards of common stock under the Restricted Stock Plan vest ratably on the first, second and third anniversary of the grant date; however, there is no vesting period on the right to vote or the right to receive dividends on these shares. As of December 31, 2008, there were a total of 84,954 shares awarded under the Restricted Stock Plan of which 37,722 shares are vested.

Audit Committee Report

The Audit Committee assists the board of directors in fulfilling its oversight responsibilities with respect to the Company's financial reporting process, by monitoring, among other matters, the quality and integrity of the Company's financial statements, the independence and performance of Deloitte & Touche LLP ("D&T"), the Company's independent registered public accounting firm, and the performance of the Company's internal auditors. Management has primary responsibility for preparing the financial statements and for the reporting processes, including the design and maintenance of the Company's system of internal controls. The independent registered public accounting firm is responsible for auditing the Company's consolidated financial statements and opining upon management's internal control assessment and upon the effectiveness of those controls in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB). The Audit Committee is solely responsible for the compensation, appointment and oversight of the Company's independent registered public accounting firm.

In this context, the Audit Committee has met and held discussions with management, the independent registered public accounting firm and the internal auditors, separately and together, with and without management present, regarding the Company's audited financial statements as of December 31, 2008, and for the year then ended and regarding the Company's internal controls. Management represented to the Audit Committee that the Company's consolidated financial statements were prepared in accordance with generally accepted accounting principles in the U.S. The Audit Committee also discussed with the independent registered public accounting firm the matters required to be discussed by PCAOB Interim Auditing Standard AU Section 380 (Communications with Audit Committees). Further, the Audit Committee discussed with the internal auditors the Company's plans for and scope of internal audits, identification of audit risks and results of audit activities.

The Audit Committee reviewed and discussed with the independent registered public accounting firm the auditor's independence from the Company and its management. As part of that review, the Company's independent registered public accounting firm submitted to the Audit Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1, as amended (Independence Discussions with Audit Committees) in which D&T affirmed its independence from the Company. Further, the Audit Committee discussed with D&T the firm's independence and considered whether D&T's provision of non-audit services to the Company was compatible with maintaining D&T's independence. The Audit Committee concluded that D&T is independent from the Company and its management.

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Based upon the considerations described above and subject to the limitations upon the role and responsibilities of the Audit Committee as set forth in the Audit Committee's Charter, the Audit Committee recommended to the board of directors that the audited financial statements for the year ended December 31, 2008 be included in the Company's 2008 Annual Report on Form 10-K.

AUDIT COMMITTEE
Peter S. Burgess, Chairman
Celia H. Currin
Charles F. Kalmbach
Jerry G. Rubenstein

Date: March 26, 2009

## PROPOSAL NUMBER TWO—APPROVAL OF AN AMENDMENT TO THE COMPANY'S 2005 NON-EMPLOYEE DIRECTORS RESTRICTED STOCK PLAN

At its February 27, 2009 meeting, the board of directors unanimously approved, subject to shareholder approval, amending the Company's 2005 Non-Employee Directors Restricted Stock Plan (the "Plan") to increase the aggregate number of shares of common stock available under the Plan to a total of 300,000 shares. The Plan was initially adopted in 2005 and, subject to certain adjustments, authorized a maximum of 100,000 shares of our common stock that may be issued for all purposes under the Plan.

As of March 17, 2009, the Company had issued 84,954 shares of the 100,000 shares authorized to date under the Plan. The Company estimates that an additional 19,000 shares will be issued in 2009. Accordingly, without this amendment, there would be insufficient authorized shares for all issuances at the 2009 Annual Meeting.

Description of the 2005 Non-Employee Directors Restricted Stock Plan, as Amended

A summary of the principal features of the Plan, as amended, is provided below, but is qualified in its entirety by reference to the full text of the Plan that is attached to this proxy statement as Annex A.

Eligibility. Only directors who are not employees of our company or any of our subsidiaries may participate in the Plan. As of the date of this proxy statement, we have eight non-employee directors.

Administration. The Plan will be administered by our compensation committee or such other committee appointed by our board. Our compensation committee will have the authority to interpret and construe the provisions of the Plan and to make all administrative rules, procedures and determinations with respect to the Plan in accordance with the terms of the Plan. Our compensation committee may designate one or more of our employees to carry out the day-to-day aspects of our compensation committee's responsibilities under the Plan.

Shares Reserved for Issuance. If amended pursuant to this proposal, the maximum number of shares of our common stock that may be issued for all purposes under the Plan will be increased to an aggregate of 300,000 shares. Shares of our common stock issued under the Plan may be either treasury shares or authorized and unissued shares. The Plan contains a standard anti-dilution provision.

Awards. An award of restricted stock or restricted stock units may be made to a non-employee director under the Plan. Awards made under the Plan are granted for no consideration other than the provision of services or for such other consideration as our compensation committee may determine or as may be required by applicable law.

Restricted Stock Awards. Subject to a deferral election, on the first day of the month following the month in which a non-employee director becomes a non-employee director, a non-employee director will receive a one-time award of restricted shares of our common stock equal to $60,000 (based on the fair market value of a share of our common stock on the date of grant) or such other amount as our compensation committee may determine from time to time.

Subject to a deferral election, as of the date of each annual meeting of our stockholders, each non-employee director will automatically receive an award of restricted shares of our common stock equal to $40,000 (based on the fair market value of a share of common stock on the date of grant). Notwithstanding the foregoing sentence, if a non-employee director (i) will not continue to serve as a director on our board immediately after the relevant annual meeting or (ii) became a director on our board within 60 days or less of the relevant annual meeting, then such non-employee director will not receive any annual award of restricted stock for such year.

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An award of restricted stock vests ratably on each of the first, second and third anniversaries of the date of grant, subject to our compensation committee's authority to accelerate the vesting of the award upon a change in control. Restricted stock will not be transferable until the later of the date on which it becomes vested (other than by the laws of descent and distribution) and six months following the date of grant. A non-employee director will have the right to vote and receive dividends upon receiving an award of restricted stock.

Deferral Election; Restricted Stock Unit Awards. Each non-employee director will be given the opportunity to make an irrevocable election to defer under our deferral plan (described in detail below) receipt of all or any portion of an award of restricted stock otherwise receivable by him or her. Any such election to defer must be made by the non-employee director within the time specified by our compensation committee no later than December 31 of the taxable year prior to the year in which the applicable award of restricted stock would otherwise be made to such director.

Where a non-employee director makes such a deferral election, he will receive a number of restricted stock units in lieu of, and equal to, the number of shares of restricted stock that is subject to the deferral election. Whereas a restricted stock award results in the immediate distribution of shares of our common stock, which remain subject to applicable vesting and transfer restrictions, a restricted stock unit award is a contractual right to receive shares of our common stock at a later date upon the satisfaction of certain vesting and settlement conditions.

The non-employee director will receive an award of these restricted stock units on the same date that the award of restricted stock subject to the deferral election would have been granted. An award of restricted stock units will vest at a rate of 331/3% on each of the first, second and third anniversaries of the date of grant, subject to our compensation committee's authority to accelerate the vesting of the award upon a change in control. Upon an award of restricted stock units, or portion thereof, becoming vested, no shares of common stock will be issued to the non-employee director. Instead, the restricted stock units will be credited to the non-employee director's account under our deferral plan on the applicable vesting date. Any restricted stock units credited to the deferral plan will be held as restricted stock units until such time as they are settled through the delivery of shares of common stock in accordance with the terms and conditions of our deferral plan. In addition, upon an award of restricted stock units, or portion thereof, becoming vested, the non-employee director will be entitled to have any dividend equivalents earned as of the applicable vesting date that correspond to such restricted stock units distributed in whole shares of our common stock.

Restricted stock units will not be transferable (other than by the laws of descent and distribution). A non-employee director will have no rights as a stockholder in our company with respect to restricted stock units held by him until shares of our common stock underlying such units are distributed.

Termination of Service. In the event that a non-employee director's service on our board terminates, our compensation committee has the authority to accelerate the vesting of an award, which action may be taken at the time of grant or at a subsequent time. In the absence of any action by our compensation committee to the contrary, upon such termination of service, such non-employee director's award will, to the extent unvested, be immediately forfeited as of such date of termination.

Amendment and Termination. Our board may, at any time, terminate, amend, modify or suspend the directors' plan, except that no amendment may be made (i) where required by applicable law or exchange rules, unless stockholder approval is obtained, or (ii) that adversely alters or affects the rights of a non-employee director with respect to any award outstanding without such director's consent. Unless terminated earlier, the directors' plan will terminate on the tenth anniversary of the date on which it was initially approved by stockholders, except with respect to awards that are then outstanding.

U.S. Federal Tax Consequences. A non-employee director will not recognize taxable income upon the grant of restricted stock or restricted stock units. Instead, the non-employee director will recognize ordinary income at the time of vesting equal to the fair market value of the shares (or cash) received minus any amounts the director paid. Any subsequent gain or loss will be capital gain or loss, long-term if the shares have been held for more than one year. For restricted stock only, the non-employee director may instead elect to be taxed at the time of grant. If the non-employee director makes such an election, the one year long-term capital gains holding period begins on the date of grant. The Company generally will receive a deduction for any ordinary income recognized by a non-employee director with respect to an award.

The foregoing is not to be considered as tax advice to any person who may be a participant, and any such persons are advised to consult their own tax counsel. The foregoing is intended to be a general discussion of U.S. Federal tax consequences, and does not cover other aspects of an individual’s unique tax situation, such as the tax consequences of deferred compensation or state and local taxes.

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Other Information. As of March 24, 2009, the closing price of a share of our common stock was $17.24.

Benefits of the Company's 2005 Non-Employee Directors Restricted Stock Plan

The table below shows restricted stock granted in 2008 to all non-employee directors as a group. None of the named executive officers or employees is eligible to participate in the Plan. The grants described in this table are not necessarily indicative of awards that we may grant in the future.

| Name and Position | Dollar Value ($) | Number of Shares |
|---|---|---|
| Non-Employee Director Group | 339,941 | 27,477 |

The board of directors recommends a vote FOR amending of the 2005 Non-Employee Directors Restricted Stock Plan.

PROPOSAL NUMBER THREE—RATIFICATION OF APPOINTMENT OF
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has appointed Deloitte & Touche LLP, which has served as the Company's independent registered public accounting firm since 1999, to be the Company's independent registered public accounting firm for the year ending December 31, 2009. Deloitte & Touche LLP has advised the Company that it does not have any direct or indirect financial interest in the Company. Representatives of Deloitte & Touche LLP are expected to attend the annual meeting and will be given the opportunity to make a statement if they choose to do so. They will also be available to respond to appropriate questions.

Before appointing Deloitte & Touche LLP, the Audit Committee carefully considered Deloitte & Touche LLP's qualifications, including the firm's performance as independent registered public accounting firm for the Company in prior years and its reputation for integrity and competence in the fields of accounting and auditing. The Audit Committee also considered whether Deloitte & Touche LLP's provision of non-audit services to the Company is compatible with its independence from the Company.

Shareholders will be asked at the annual meeting to ratify the appointment of Deloitte & Touche LLP. If the shareholders ratify the appointment, the Audit Committee may still, in its discretion, appoint a different independent registered public accounting firm at any time

during the year 2009 if it concludes that such a change would be in the best interests of the Company. If the shareholders fail to ratify the appointment, the Audit Committee will reconsider, but not necessarily rescind, the appointment of Deloitte & Touche LLP.

Fees Billed by Independent Registered Public Accounting Firm

As more fully described below, all services to be provided by Deloitte & Touche LLP are pre-approved by the Audit Committee, including audit services, tax services and certain other services.

The SEC requires disclosure of fees billed by the Company's independent registered public accounting firm for certain services. The following table sets forth the aggregate fees billed to Deloitte & Touche LLP during the years ended December 31, 2008 and 2007:

| Fee Category | 2008 | 2007 |
| --- | --- | --- |
| Audit and Audit Related Fees | $ 768,550 | $ 722,800 |
| Tax Fees | 137,337 | 95,100 |
| All Other Fees | 392,800 | 25,700 |
| Total Fees | $ 1,298,727 | $ 843,600 |

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Audit and Audit Related Fees consisted principally of audit services of our consolidated financial statements, review of our quarterly financial statements, services that are normally provided by the independent auditors in connection with statutory and regulatory filings and the audit of management's report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002.

Tax Fees consisted principally of professional services rendered by Deloitte & Touche LLP in connection with the Company's tax compliance activities, including technical and tax advice related to the preparation of tax returns.

All Other Fees consisted of professional services rendered in connection with the Company's 401(k) and pension plan audits. In 2008, such fees also included professional services rendered in connection with two registration statements on Form S-3, filed by the Company with the SEC during 2008 and consultation regarding the acquisition of Baran Institute of Technology, Inc.

Audit Committee Pre-Approval Policy

The Audit Committee approves, prior to engagement, all audit and non-audit services provided by Deloitte & Touche LLP and all fees to be paid for such services. All services are considered and approved on an individual basis. In its pre-approval and review of non-audit service fees, the Audit Committee considers, among other factors, the possible effect of the performance of such services on the auditors' independence.

Required Vote

A majority of the votes cast at the annual meeting will be required to ratify the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for 2009.

The board of directors recommends a vote FOR the ratification of the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for 2009.

## ANNUAL REPORT AND FINANCIAL STATEMENTS AND COMMITTEE AND CORPORATE GOVERNANCE MATERIALS OF THE COMPANY

Copies of the Company's Annual Report filed with the SEC on Form 10-K for the year ended December 31, 2008, including the Company's consolidated financial statements and financial statement schedule, will be mailed to interested shareholders, without charge, upon written request. Exhibits to the Form 10-K will be provided

upon written request and payment to the Company of the cost of preparing and distributing those materials. The current charters of the Board's Audit, Compensation, Nominating and Corporate Governance Committees, along with the Company's Code of Business Ethics and Conduct and Integrity Assurance Program, are available to interested shareholders upon request and are posted on our website at www.lincolnedu.com. Written requests should be sent to Lincoln Educational Services Corporation, 200 Executive Drive, Suite 340, West Orange, New Jersey 07052, Attention: Investor Relations.

## CORPORATE GOVERNANCE GUIDELINES AND CODE OF ETHICS

The board of directors has adopted corporate governance guidelines, which include guidelines for determining director independence, director responsibilities, director access to management and independent advisors, and director stock ownership guidelines. The board of directors has determined that the following six directors satisfy the Nasdaq Global Market's independence requirements: Messrs. Burgess, Glaske, Kalmbach, Morrow, Rubenstein and Ms. Currin.

The board of directors has adopted an Integrity Assurance Program – A Code of Business Ethics and Conduct that applies to all directors, officers and employees and that is intended, among other things, to comply with Section 406 of the Sarbanes-Oxley Act of 2002 and related SEC and Nasdaq Global Market rules requiring a code of ethics for a company's directors, officers and employees. A copy of the Integrity Assurance Program – A Code of Business Ethics and Conduct is posted on our website at www.lincolnedu.com. The Audit Committee must approve any requests for amendments to or waivers from the Integrity Assurance Program with respect to directors and executive officers and the Company intends to report such amendments or waivers that are required to be reported pursuant to the rules of the SEC and the Nasdaq Global Market on the Company's website.

### Transactions with Related Persons

The Company recognizes that related person transactions present a heightened risk of conflicts of interest.  As a general matter, it is the preference of the Company to avoid related person transactions.  The term "related person transaction" refers to a transaction required to be disclosed pursuant to Item 404 of Regulation S-K, under the Securities Act of 1933, as amended.

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Nevertheless, the Company recognizes that there are situations where related person transactions may be in, or may not be inconsistent with, the best interests of the Company and its shareholders. As a result, pursuant to the Company's Audit Committee (the "Committee") written charter, the Committee is charged with the responsibility to review and approve all related person transactions on an ongoing basis. All such transactions must be approved in advance by the Audit Committee.

In addition, the Company's Code of Business Ethics and Conduct (the "Code of Conduct") contains policies and procedures with respect to conflicts of interest and related person transactions. The Code of Conduct requires that all directors, officers, employees and certain other persons subject to the Code of Conduct, adhere to it and prohibits certain arrangements that may be relevant to related person transactions including, but not limited to, prohibitions against: obtaining a substantial interest in any entity which does or seeks to do business with, or is a competitor of, the Company; entering into various arrangements (including family or other relationships) which might dissuade such director, officer, employee or other person from acting in the best interest of the Company; entering into a financial transaction or relationship with a student, prospect, vendor, agent or competitor of the Company; benefiting, or seeking to benefit, (directly or indirectly) from such person's position with the Company from any sale, purchase or other activity of the Company; using Company property or information for personal gain; obtaining loans or guarantees for personal obligation from the Company; and competing with the Company.

On May 12, 2008, we repurchased from Five Mile River Capital Partners and Steven W. Hart an aggregate 100,000 shares of our common stock for $11.25 per share for a total cost of $1.1 million. Hart Capital LLC is the managing member of Five Mile River Capital Partners LLC, our second largest stockholder. Steven W. Hart is the owner and president of Hart Capital LLC and is a former member of our board of directors. At the time of the transaction Hart Capital beneficially owned, through Five Mile River Capital LLC, 8.3% of our outstanding shares of common stock.

On October 15, 2007, we entered into a Separation and Release Agreement with Lawrence E. Brown, our former Vice Chairman. Under this agreement Mr. Brown's employment terminated as of the close of business on October 31, 2007. For a period of 14 months following the date of separation of employment, Mr. Brown continued to provide transitional services to us, not to exceed ten hours per month. In consideration for a release of claims, we paid Mr. Brown a lump sum cash payment of $0.5 million and reimbursed Mr. Brown for the employer-portion of the premiums due for continuation of coverage under COBRA through December 31, 2008. Mr. Brown was entitled to the use of his automobile and reimbursement of

associated costs by us through December 31, 2008. In addition, pursuant to the terms of the agreement, Mr. Brown agreed to be subject to certain restrictive covenants, which, among other things, prohibited him for the duration of 14 months following the date of separation of employment, from (i) competing against us and (ii) soliciting our or any of our affiliates' or subsidiaries' employees, consultants, clients or customers through December 31, 2008.

## SHAREHOLDER PROPOSALS FOR THE 2010 ANNUAL MEETING OF SHAREHOLDERS

Shareholder proposals that are intended to be presented at the 2010 Annual Meeting of Shareholders pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, as amended, must be received by the Secretary of the Company, in writing, no later than November 27, 2009 in order to be considered for inclusion in the Company's proxy materials for that annual meeting. Shareholder proposals and shareholder nominations for election to the board of directors must also comply with the current advance notice and other requirements set forth in the Company's bylaws to be eligible to be presented at an annual meeting. These requirements include, in part, the requirement that any such proposal or nomination must, with certain exceptions if the date of the annual meeting is advanced or delayed more than 30 days from that of the first anniversary of this year's annual meeting, be submitted to the Secretary of the Company at least 120 and not more than 150 days prior to the first anniversary of the date of mailing of the notice for this year's annual meeting (or between October 28, 2009 and November 27, 2009 based on this year's notice mailing date of March 27, 2009).

## COMMUNICATING WITH THE BOARD OF DIRECTORS

You may contact any non-employee director, or the entire board, at any time. Your communication should be sent to the Lincoln Educational Services Corporation Board of Directors – Non-Employee Directors, c/o Corporate Secretary, Lincoln Educational Services Corporation, 200 Executive Drive, Suite 340, West Orange, New Jersey 07052.

Communications are distributed to the board, or any board member as appropriate, depending on the facts and circumstances outlined in the communication. Certain items that are unrelated to the duties and responsibilities of the board will be excluded, such as spam and other junk mail, resumes and other job inquiries, surveys and business solicitations or advertisements.

Material that is unduly hostile, threatening, illegal or similarly unsuitable will also be excluded. We will make available to any non-employee director any communication that is filtered in accordance with the process described above, at that director's request.

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HOUSEHOLDING OF ANNUAL MEETING MATERIALS

Some banks, brokers and other nominee record holders may participate in the practice of "householding" proxy statements and annual reports. This means that unless stockholders give contrary instructions, only one copy of our proxy statement or annual report may be sent to multiple stockholders in each household who share an address. We will promptly deliver a separate copy of either document to you if you call or write to us at the following address or telephone number: Lincoln Educational Services Corporation, c/o Corporate Secretary, 200 Executive Drive, Suite 340, West Orange, New Jersey 07052, telephone (973) 736-9340. If you want to receive separate copies of our proxy statement or annual report in the future, or if you are receiving multiple copies and would like to receive only one copy per household, you should contact your bank, broker or other record holder, or you may contact us at the above address or telephone number.

OTHER INFORMATION

Proxy authorizations submitted via the Internet must be received by 5:00 p.m. (Eastern Time) on April 29, 2009. To give your proxy authorization via the Internet, please read the instructions accompanying the enclosed proxy card. Costs associated with electronic access, such as from access providers, will be borne by the shareholder.

By Order of the Board of Directors

/s/ Kenneth M. Swisstack
Kenneth M. Swisstack
Corporate Secretary

West Orange, New Jersey
March 27, 2009

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Annex A

# LINCOLN EDUCATIONAL SERVICES CORPORATION 2005 NON-EMPLOYEE DIRECTORS RESTRICTED STOCK PLAN

## 1. Purpose of the Plan

The Plan is intended to encourage ownership of Common Stock by Non-Employee Directors of the Company, upon whose judgment and interest the Company is dependent for its successful operation and growth, in order to increase their proprietary interest in the Company's success and to encourage them to serve as directors of the Company.

## 2. Definitions and Rules of Construction

(a) Definitions. For purposes of the Plan, the following capitalized words shall have the meanings set forth below:

"Annual Meeting" means an annual meeting of the Company's stockholders.

"Award" means an award of Restricted Stock or Restricted Stock Units made pursuant to the terms of the Plan.

"Award Document" means an agreement, certificate or other type or form of document or documentation approved by the Committee which sets forth the terms and conditions of an Award. An Award Document may be in written, electronic or other media, may be limited to a notation on the books and records of the Company and, unless the Committee requires otherwise, need not be signed by a representative of the Company or a Non-Employee Director.

"Board" means the Board of Directors of the Company, including any directors who may be participants in the Plan.

"Change in Control" means a "Change in Control" as defined in the Company's 2005 Long-Term Incentive Plan.

"Code" means the Internal Revenue Code of 1986, as amended, and the applicable rulings and regulations thereunder.

"Committee" means the Compensation Committee of the Board or such other committee appointed by the Board to administer the Plan.

"Common Stock" means the common stock of the Company, no par value per share, or such other class of share or other securities as may be applicable under Section 9(b) hereof.

"Company" means Lincoln Education Services Corporation, or any successor to substantially all of its business.

"Date of Grant" means the date on which a Non-Employee Director is granted an Award.

"Deferral Election" means a Non-Employee Director's irrevocable, written election to defer his Award of Restricted Stock in accordance with Section 8 hereof.

"Deferral Plan" means the Company's 2005 Deferred Compensation Plan or any successor plan thereto.

"Effective Date" means the date on which the Plan is approved by the stockholders of the Company.

"Exchange Act" means the Securities and Exchange Act of 1934, as amended, and the rules and regulations thereunder.

"Fair Market Value" means (i) if the Common Stock is listed on a securities exchange or is traded over the Nasdaq National Market, the closing sales price on such exchange or over such system on such date or, in the absence of reported sales on such date, the closing sales price on the immediately preceding date on which sales were reported, or (ii) if the Common Stock is not listed on a securities exchange or traded over the Nasdaq National Market, the mean between the bid and offered prices as quoted by Nasdaq for such date, provided that if it is determined that the fair market value is not properly reflected by such Nasdaq quotations, Fair Market Value shall be determined by such other method as the Committee determines in good faith to be reasonable.

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"Non-Employee Director" means a director of the Company who is not an officer or employee of the Company or any Subsidiary.

"Plan" means this Lincoln Educational Services Corporation 2005 Non-Employee Directors Restricted Stock Plan, as described herein.

"Plan Limit" has the meaning assigned to such term in Section 5 hereof.

"Restricted Stock" means restricted shares of Common Stock granted to a Non-Employee Director pursuant to Section 7 hereof. One share of Restricted Stock corresponds to one share of Common Stock.

"Restricted Stock Units" mean a contractual right to receive shares of Common Stock at a subsequent date upon satisfaction of the conditions to vesting and settlement pursuant to Section 8 hereof. One Restricted Stock Unit corresponds to one share of Common Stock.

"Subsidiary" means (i) a domestic or foreign corporation or other entity with respect to which the Company, directly or indirectly, has the power, whether through the ownership of voting securities, by contract or otherwise, to elect at least a majority of the members of such corporation's board of directors or analogous governing body, or (ii) any other domestic or foreign corporation or other entity in which the Company, directly or indirectly, has an equity or similar interest and which the Board designates as a Subsidiary for purposes of the Plan.

"Vesting Date" has the meaning assigned to such term in Section 8(c) hereof.

(b) Rules of Construction. The masculine pronoun shall be deemed to include the feminine pronoun and the singular form of a word shall be deemed to include the plural form, unless the context requires otherwise. Unless the text indicates otherwise, references to sections are to sections of the Plan.

3. Administration

(a) Authority. Subject to the provisions of Section 12 hereof, the Committee shall have authority to interpret the provisions of the Plan, to establish such rules and procedures as may be necessary or advisable to administer the Plan and to make all determinations necessary or advisable for the administration of the Plan, including, without limitation, factual and legal determinations; provided, however, that no such interpretation or determination shall change or affect the selection of persons eligible to receive an Award under the Plan, the number of shares authorized under the Plan or the terms and conditions thereof. The interpretation and construction by the Committee of any provision of the Plan or of

any Award Document shall be final, binding and conclusive on all parties.

(b) Delegation. The Committee may designate one or more employees of the Company to carry out the day-to-day aspects of the Committee's responsibilities under such conditions as it may set.

4. Eligibility

Awards under the Plan shall be granted pursuant to the provisions hereof to persons who are Non-Employee Directors.

5. Plan Limit

Subject to Section 9(b) hereof, the Company is authorized to issue up to 300,000 shares of Common Stock under the Plan (the "Plan Limit"). Such shares may be authorized but unissued shares of Common Stock or reacquired shares of Common Stock held in the treasury of the Company.

6. Awards in General

(a) General. The terms and conditions of each Award shall be set forth in an Award Document, which shall contain terms and conditions not inconsistent with the Plan. Each Award made to a Non-Employee Director under the Plan shall be granted for no consideration other than the provision of services (or such minimum payment as may be required under applicable law) or for such other consideration as the Committee may determine.

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(b) Effect of Termination of Service. Notwithstanding any provision of the Plan to the contrary, in the event that a Non-Employee Director's service on the Board terminates, the Committee shall have full authority and discretion to accelerate the vesting of an Award, which provisions may be specified in the applicable Award Document or determined at a subsequent time. In the absence of any action by the Committee to the contrary, upon such termination of service, the Non-Employee Director's Award shall, to the extent unvested, be immediately forfeited as of such date of termination of service. The date of a Non-Employee Director's termination of service from the Board for any reason shall be determined in the sole discretion of the Committee.

7. Terms and Conditions of Restricted Stock Awards

The terms of this Section 7 are subject to the terms and provisions set forth above in Section 6.

(a) Initial Grant of Restricted Stock. Subject to the provisions of Section 8, each Non-Employee Director shall receive an Award of shares of Restricted Stock equal to $60,000 (based on the Fair Market Value of a share of Common Stock on the Date of Grant) or such other amount as the Committee may determine from time to time for service as a director of the Company on the first day of the calendar month following the month in which such Non-Employee Director becomes a Non-Employee Director.

(b) Annual Grants of Restricted Stock. Subject to the provisions of Sections 7 and 8, as of the date of each Annual Meeting commencing in 2006, each Non-Employee Director shall automatically receive an Award of shares of Restricted Stock equal to $40,000 (based on the Fair Market Value of a share of Common Stock on the Date of Grant) for service as a director of the Company, provided that such Non-Employee Director shall continue to serve as a director of the Company immediately after such Annual Meeting, provided further that if a person is elected, appointed or otherwise becomes a Non-Employee Director during a period of 60 days prior to the Annual Meeting in any year, then such Non-Employee Director shall not receive any Award of Restricted Stock pursuant to this Section 7(b) for such year.

(c) Vesting. An Award of Restricted Stock shall vest and become nonforfeitable at a rate of 33 1/3% on each of the first, second and third anniversaries of the Date of Grant (subject to early vesting, if so provided by the Committee in its sole discretion in the applicable Award Document or at a subsequent time, upon a Change in Control of the Company).

(d)

Issuance of Shares. A certificate representing the whole shares of Common Stock covered by an Award of Restricted Stock shall be issued in the Non-Employee Director's name, subject to the terms and conditions of the Plan and the applicable Award Document, promptly after the Date of Grant, and such a Non-Employee Director shall be deemed to own such number of whole shares of Common Stock, including, without limitation, for purposes of dividends and voting, as of the Date of Grant. The Board may require that the certificate evidencing such shares be held in custody by the Company until the restrictions thereon shall have lapsed, and that, as a condition of any Award of Restricted Stock, the Eligible Director shall have delivered a stock power, endorsed in blank, relating to the Common Stock covered by such Award of Restricted Stock.

(e) Restrictions on Transfer of Restricted Stock. Unless the Committee determines otherwise, Restricted Stock shall not be transferable other than by the laws of descent and distribution until such Restricted Stock has vested pursuant to Section 7(c) but, in no event, prior to the expiration of a period of six (6) months from the Date of Grant.

8. Deferral Election; Terms and Conditions of Restricted Stock Unit Awards

The terms of this Section 8 are subject to the terms and provisions set forth above in Section 6.

(a) Deferral Election. Notwithstanding any provision of Section 7, each Non-Employee Director shall be given the opportunity to irrevocably elect to defer under the Deferral Plan receipt of all or any portion of an Award of Restricted Stock otherwise receivable by him under paragraph (a) or (b) of Section 7 through a Deferral Election. Any Deferral Election must be made by a Non-Employee Director within the requisite time specified by the Committee, but in no event later than December 31 of the taxable year prior to the year in which the applicable Award of Restricted Stock is granted to such Non-Employee Director.

(b) Grant of Restricted Stock Units. When a Non-Employee Director makes a Deferral Election, he shall receive a number of Restricted Stock Units in lieu of, and equal to, the number of shares of Restricted Stock that is subject to such Deferral Election. The Non-Employee Director shall receive an Award of these Restricted Stock Units on the same date that the Award of Restricted Stock subject to the Deferral Election otherwise would have been granted to him under paragraph (a) or (b), as applicable, of Section 7. Except as otherwise provided by the Committee in any Award Document, the terms and conditions applicable to an Award of Restricted Stock Units are described in this Section 8.

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(c) Vesting. An Award of Restricted Stock Units shall vest and become nonforfeitable at a rate of 33 1/3% on each of the first, second and third anniversaries of the Date of Grant (each, a "Vesting Date") (subject to early vesting, if so provided by the Committee in its sole discretion in the applicable Award Document or at a subsequent time, including, without limitation, upon a Change in Control of the Company).

(d) No Issuance of Shares; Deferral. Subject to Section 8(f), upon an Award of Restricted Stock Units, or a portion thereof, becoming vested, no shares of Common Stock shall be issued to the Non-Employee Director. Instead, the Restricted Stock Units shall be credited, without any further action on the part of the Non-Employee Director, to the Non-Employee Director's deferred compensation account under the Deferral Plan on the applicable Vesting Date. Any Restricted Stock Units credited to the Deferral Plan shall be held in the Deferral Plan as Restricted Stock Units until such time as they are settled through the delivery of shares of Common Stock in accordance with the terms and conditions of the Deferral Plan.

(e) Restrictions on Transfer of Restricted Stock Units. Unless the Committee determines otherwise, Restricted Stock Units shall not be transferable other than by the laws of descent and distribution.

(f) Dividend Equivalent Payments. Unless the Committee determines otherwise, if the Company pays any cash or other dividend or makes any other distribution in respect of the shares of Common Stock underlying an Award of Restricted Stock Units, or a portion thereof, before such Restricted Stock Units are credited to the Deferral Plan in accordance with the terms of Section 8(d), the Company shall maintain a bookkeeping record to which such amount of the dividend or distribution in respect of such shares of Common Stock shall be credited to an account for the Non-Employee Director and distributed in whole shares of Common Stock at the time the Award, or portion thereof is vested.

(g) No Rights as a Stockholder. Except as otherwise provided by the Committee in the applicable Award Document, a Non-Employee Director shall have no rights as a stockholder with respect to any Awards of Restricted Stock Units or any value thereof deferred under the Deferral Plan.

9. No Restriction on Right of Company to Effect Corporate Changes

(a) Authority of the Company and Stockholders. The existence of the Plan, the Award Documents and the Awards granted hereunder shall not affect or restrict in any way the right or power of the Company or the stockholders of the Company to make or authorize

any adjustment, recapitalization, reorganization or other change in the Company's capital structure or its business, any merger or consolidation of the Company, any issue of stock or of options, warrants or rights to purchase stock or of bonds, debentures, preferred or prior preference stocks whose rights are superior to or affect the Common Stock or the rights thereof or which are convertible into or exchangeable for Common Stock, or the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding, whether of a similar character or otherwise.

(b) Change in Capitalization. Notwithstanding any provision of the Plan or any Award Document, the number and kind of shares authorized for issuance under Section 5 hereof may be equitably adjusted in the sole discretion of the Committee in the event of a stock split, stock dividend, recapitalization, reorganization, merger, consolidation, extraordinary dividend, split-up, spin-off, combination, exchange of shares, warrants or rights offering to purchase Common Stock at a price substantially below Fair Market Value or other similar corporate event affecting the Common Stock in order to preserve, but not increase, the benefits or potential benefits intended to be made available under the Plan. In addition, upon the occurrence of any of the foregoing events, the number and kind of shares subject to any outstanding Awards may be equitably adjusted (including by payment of cash to a Non-Employee Director) in the sole discretion of the Committee in order to preserve the benefits or potential benefits intended to be made available to Non-Employee Directors granted Awards. Such adjustments shall be made by the Committee, in its sole discretion, whose determination as to what adjustments shall be made, and the extent thereof, shall be final. Unless otherwise determined by the Committee, such adjusted Awards shall be subject to the same restrictions to which the underlying Award is subject.

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10. Miscellaneous

(a) Tax Withholding. The Company shall require as a condition to delivery of shares of Common Stock that the Non-Employee Director remit an amount sufficient to satisfy all applicable tax withholding requirements (if any) and any or all indebtedness or other obligation of the Non-Employee Director to the Company or any of its Subsidiaries.

(b) No Right to Continued Directorship. Nothing in the Plan shall confer upon any Non-Employee Director the right to continue as a director of the Company or affect any right that the Company or any Non-Employee Director may have to terminate the service of such Non-Employee Director.

(c) Section 16(b) of the Exchange Act. The Plan is intended to comply in all respects with Section 16(b) of the Exchange Act. Notwithstanding anything contained in the Plan or any Award Document under the Plan to the contrary, if the consummation of any transaction under the Plan, or the taking of any action by the Committee in connection with a Change in Control of the Company, would result in the possible imposition of liability on a Non-Employee Director pursuant to Section 16(b) of the Exchange Act, the Committee shall have the right, in its sole discretion, but shall not be obligated, to defer such transaction or the effectiveness of such action to the extent necessary to avoid such liability, but in no event for a period longer than 180 days.

(d) Securities Law Restrictions. The Committee may require each Non-Employee Director purchasing or acquiring shares of Common Stock pursuant to an Award under the Plan to represent to and agree with the Company in writing that such Non-Employee Director is acquiring the shares of Common Stock for investment purposes and not with a view to the distribution thereof. All certificates for shares of Common Stock delivered under the Plan shall be subject to such stock-transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any exchange upon which the shares of Common Stock are then listed, and any applicable securities law, and the Committee may cause a legend or legends to be put on any such certificates to make appropriate reference to such restrictions.

(e) Governing Law. The Plan and all agreements entered into under the Plan shall be construed in accordance with and governed by the laws of the State of New York.

(f) Unfunded Plan. The Plan is intended to constitute an unfunded plan for incentive compensation. Prior to the issuance of Shares in

connection with an Award, nothing contained herein shall give any Participant any rights that are greater than those of a general unsecured creditor of the Company. In its sole discretion, the Committee may authorize the creation of trusts or other arrangements to meet the obligations created under the Plan to deliver Shares with respect to awards hereunder.

(g) Section 409A of the Code. If any provision of the Plan or an Award Document contravenes any regulations or Department of Treasury guidance promulgated under Section 409A of the Code or could cause an Award to be subject to the interest and penalties under Section 409A of the Code, such provision of the Plan or any Award Document shall be modified to maintain, to the maximum extent practicable, the original intent of the applicable provision without violating the provisions of Section 409A of the Code.

11. Term of the Plan

Unless earlier terminated pursuant to Section 12 hereof, the Plan shall terminate on the tenth anniversary of the Effective Date, except with respect to Awards then outstanding.

12. Amendment and Termination

The Plan may be terminated and may be modified or amended by the Board at any time and from time-to-time; provided, however, that (i) no modification or amendment shall be effective without stockholder approval if such approval is required by law or under the rules of Nasdaq or the stock exchange on which the shares are listed, and (ii) no such termination, modification, or amendment of the Plan shall adversely alter or affect the terms of any then outstanding Awards previously granted hereunder without the consent of the holder thereof. Notwithstanding the foregoing, the Board shall have broad authority to amend the Plan or any Award under the Plan without the consent of a Participant to the extent it deems necessary or desirable to (a) comply with, or take into account changes in applicable tax laws, securities laws, accounting rules and other applicable laws, rules and regulations or (b) to ensure that an Award is not subject to interest and penalties under Section 409A of the Code.

ANNUAL MEETING OF SHAREHOLDERS OF
LINCOLN EDUCATIONAL SERVICES CORPORATION

April 30, 2009

Please date, sign and mail your proxy card in the
envelope provided as soon as possible.

v FOLD AND DETACH HERE AND READ THE REVERSE SIDE v

PLEASE SIGN, DATE AND RETURN PROMPTLY IN THE
ENCLOSED ENVELOPE.
PLEASE MARK YOUR VOTE IN BLUE OR BLACK INK AS
SHOWN HERE x

The Board of Directors recommends a vote FOR Items 1, 2 and 3.

1. Election of Directors:

| | |
|---|---|
| o Peter S. Burgess | o James J. Burke, Jr. |
| o David F. Carney | o Celia H. Currin |
| o Paul E. Glaske | o Charles F. Kalmbach |
| o Shaun E. McAlmont | o Alexis P. Michas |
| o J. Barry Morrow | o Jerry G. Rubenstein |

| FOR ALL NOMINEES | WITHHOLD AUTHORITY | FOR ALL EXCEPT (See instructions below) |
|---|---|---|
| o | o | o |

INSTRUCTION: To withhold authority to vote for any individual nominee(s), mark “FOR ALL EXCEPT” and fill in the square next to each nominee you wish to withhold, as shown here: x

To change the address on your account, please check the box at right and indicate your new address in the address space to the left. Please note that changes to the registered name(s) on the account may not be submitted via this method. o

2.

Amendment of the Company’s 2005 Non-Employee Directors Restricted Stock Plan.

| FOR | AGAINST | ABSTAIN |
|---|---|---|
| o | o | o |

3. Ratification of the appointment of Deloitte & Touche LLP to serve as the Company’s independent registered public accounting firm for the fiscal year ending December 31, 2009.

| FOR | AGAINST | ABSTAIN |
|---|---|---|
| o | o | o |

4. To transact such other business as may properly come before the Annual Meeting or any adjournment(s) or postponement(s) thereof and as to which the undersigned hereby confers discretionary authority to the proxies.

CHECK HERE IF YOU PLAN TO ATTEND THE MEETING o

| Signature of Shareholder | Date: | Signature of Shareholder | Date: |
|---|---|---|---|

Note: Please sign exactly as your name appears hereon. When shares are held by joint owners, both should sign. When signing as attorney, executor, administrator, trustee or guardian, please give title as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by authorized person.

LINCOLN EDUCATIONAL SERVICES CORPORATION

Proxy For Annual Meeting of Shareholders

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned shareholder of Lincoln Educational Services Corporation, a New Jersey corporation (the "Company"), hereby appoints David F. Carney and Cesar Ribeiro, and each of them, as proxies for the undersigned, with full power of substitution in each of them, to attend the Annual Meeting of Shareholders of the Company to be held on Thursday, April 30, 2009, at 10:00 a.m., local time, at the Wilshire Grand Hotel, 350 Pleasant Valley Way, West Orange, New Jersey 07052, and any adjournment(s) or postponement(s) thereof, to cast on behalf of the undersigned all votes that the undersigned is entitled to cast at such meeting and otherwise to represent the undersigned at the meeting, with the same effect as if the undersigned were present. The undersigned hereby acknowledges receipt of the Notice of Annual Meeting of Shareholders and the accompanying Proxy Statement and revokes any proxy previously given with respect to such shares.

THE VOTES ENTITLED TO BE CAST BY THE UNDERSIGNED WILL BE CAST IN ACCORDANCE WITH THE SPECIFICATIONS MADE BY THE UNDERSIGNED. IF THIS PROXY IS EXECUTED, BUT NO SPECIFICATION IS MADE BY THE UNDERSIGNED, THE VOTES ENTITLED TO BE CAST BY THE UNDERSIGNED WILL BE CAST "FOR" ALL NOMINEES AND THE FOREGOING PROPOSALS AND OTHERWISE IN THE DISCRETION OF THE PROXIES AT THE ANNUAL MEETING OR ANY ADJOURNMENT(S) OR POSTPONEMENT(S) THEREOF.

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