Kornit Digital Ltd.
Form 20-F
March 20, 2018

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, 2017

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.

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(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, 2017, the registrant had outstanding:

34,124,223 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post 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: 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 expand into 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 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.

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.

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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, 2015, 2016 and 2017 and selected consolidated balance sheet data as of December 31, 2016 and 2017 are derived from our audited consolidated financial statements appearing in ITEM 18. Financial Statements. The selected consolidated statements of income data for the year ended December 31, 2013 and 2014 and the selected consolidated balance sheet data as of December 31, 2013, 2014 and 2015 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,				
	2013	2014	2015	2016	2017
	(in thousands, except share and per share data)				
Consolidated Statements of Income:					
Revenues	$49,395	$66,364	$86,405	$108,694	$114,088

Cost of revenues[1]	27,953	37,187	45,820	59,284	59,977
Gross profit	21,442	29,177	40,585	49,410	54,111
Operating expenses:					
Research and development[1]	7,443	9,475	11,950	17,383	20,834
Sales and marketing[1]	7,734	10,616	13,367	18,338	21,279
General and administrative[1]	3,278	5,266	9,500	12,259	13,578
Restructuring expenses	-	-	-	-	503
Total operating expenses	18,455	25,357	34,817	47,980	56,194
Operating income (loss)	2,987	3,820	5,768	1,430	(2,083)
Finance income (expenses), net	(460)	(15)	(334)	46	452
Income (loss) before taxes on income	2,527	3,805	5,434	1,476	(1,631)
Taxes on income	1,393	782	709	648	384
Net income (loss)	$1,134	$3,023	$4,725	$828	$(2,015)
Net earnings (loss) per ordinary share[2]					
Basic	$0.13	$0.34	$0.19	$0.03	$(0.06)
Diluted	$0.11	$0.29	$0.18	$0.03	$(0.06)
Weighted average number of ordinary shares used in computing income per ordinary share[2]					
Basic	8,953,565	8,969,588	24,633,369	30,562,255	33,574,147
Diluted	9,880,049	10,446,329	26,458,584	31,732,532	33,574,147

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	As of December 31,				
	2013	2014	2015	2016	2017
	(in thousands)				
Consolidated balance sheet data:					
Cash and cash equivalents	$5,329	$4,993	$18,464	$22,789	$18,629
Working capital(3)	12,811	14,863	65,455	68,651	63,907
Total assets	31,627	34,714	123,352	140,046	178,374
Total long term liabilities	1,617	2,025	1,839	2,725	2,155
Total shareholders' equity	15,608	19,351	100,262	107,188	150,699

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

	Year Ended December 31,				
	2013	2014	2015	2016	2017
	(in thousands)				
Share-based compensation expense:					
Cost of revenues	$11	$96	$306	$482	$629
Research and development	21	86	281	217	775
Sales and marketing	66	207	537	654	920
General and administrative	28	508	1,259	1,640	2,087
Total share-based compensation expense	$126	$897	$2,383	$2,993	$4,411

(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 years ended December 31, 2013 and 2014.

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."

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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.

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 voids 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. 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 and a number of smaller competitors with respect to our entry level system. Our competitors in the R2R market include: Dover Corporation through its MS Printing Solutions S.r.l. subsidiary, Durst Phototechnik AG; Electronics for Imaging, Inc. through its Reggiani Macchine SpA subsidiary; Mimaki Engineering Co., Ltd.; 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 R2R market have become increasingly interested in moving from rotary screen printing to digital printing and have broadened their product offering by merging with or acquiring other companies in the R2R 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 roll-to-roll 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.

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A significant portion of our sales is concentrated among one of our independent distributors and a small number of customers, and our business would be adversely affected by a decline in sales to, or the loss of, this distributor or these customers.

Our primary distributor in the United States, Hirsch International Corporation, accounted for approximately 21% and 18% of our revenues in 2016 and 2017, respectively. We have entered into a non-exclusive distributor agreement with Hirsch with a term that ends in April 2018 subject to automatic renewal for successive one-year periods unless one party notifies the other party that it does not wish to renew the agreement. Hirsch may fail to devote the same level of attention to our solutions as it currently does, elect to distribute competitors' products or be less successful than distributors of competitors' products in their territories and, as a result, sales of our solutions may suffer. In addition, our relationship with Hirsch could be terminated with little or no notice if Hirsch becomes subject to bankruptcy or other similar proceedings or otherwise becomes unable or unwilling to continue its business relationship with us, and we may not be able to find a qualified and successful replacement in a timely manner. Additionally, a default by Hirsch at a time that it has a significant receivables balance with us could harm our financial condition. For the year ended December 31, 2016 and 2017, Amazon Corporate LLC, a subsidiary of Amazon.com, Inc., accounted for approximately 16% and 13% of our revenues, respectively. During 2017, we experienced delays in delivery of systems to Amazon due to delays in obtaining certain regulatory permits for an Amazon site, which negatively affected our revenues and profitability. Our ten largest customers accounted for approximately 55% of our revenues for the year ended December 31, 2017. The loss of either this distributor or customer, or another one of our significant customers, or variability in their order flows could materially adversely affect our revenues. Due to the concentration of our revenues with this distributor and customer, any such event could have a material adverse effect on our 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 quarter, 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.

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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.

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. Since the value of the warrants depends, in part, on the price of our shares and their volatility, 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, particularly in light of the fact that such 12 month periods are not concurrent with our reporting periods, and may cause fluctuations in our quarterly and annual revenues, gross profit and operating profit.

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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.

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.

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.

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. We also rely on contract manufacturing services provided by Flex Israel Ltd. and ITS Industrial Techno Logic Solutions 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 and at the facilities of a new provider with which we have an initial agreement and are currently negotiating a manufacturing services agreement.

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.

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.

Systems we introduced during the past three years or that are in development may not achieve market acceptance or gain adequate market share and may otherwise affect our results of operations.

Since 2015, we introduced several new systems to the market. We began selling our Allegro system commercially in the R2R market in the second quarter of 2015. During 2016, we commercially launched a new DTG system, the Vulcan, which is a digital alternative for carousel screen printing within the direct-to-garment segment. In January 2018, we launched new systems as part of our Avalanche line which incorporate certain advanced hardware, software and consumables. 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. In the event that we are unable to achieve market acceptance of our new systems, our growth and future prospects may be adversely affected. 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,

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

Our operating margin was 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 $114.1 million in 2017. Our headcount increased from 251 as of December 31, 2014 to 412 as of December 31, 2017. 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. 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.

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 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 appreciated 8.6% against the NIS in 2015, depreciated by 1.1% and 6.3% against the NIS in 2016 and 2017, respectively. During these periods, there was deflation in Israel of 1.0% and 0.2% in 2015 and 2016, respectively, and inflation of 0.4% in 2017. 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.”

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.

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 (FCPA), 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 we have and 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.

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.

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As of December 31, 2017, we owned fourteen (14) issued patents in the United States and twenty-two (22) provisional or pending U.S. patent applications, along with twenty-seven (27) pending non-U.S. patent applications. We also had eleven (11) patents issued in non-U.S. jurisdictions, and ten (10) 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 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).

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.

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.

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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.

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.

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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 $22.40 and as low as $8.10 through March 15, 2018. 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;
- 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.

Fortissimo Capital has a significant influence over matters requiring shareholder approval, which could delay or prevent a change of control.

As of February 28, 2018, Fortissimo Capital beneficially owns approximately 13.3% of our ordinary shares and three of its principals are members of our board of directors.

As a result, this shareholder could exert significant influence over our operations and business strategy with respect to matters such as:

- approving or rejecting a merger, consolidation or other business combination;
- raising future capital; and
- amending our articles, which govern the rights attached to our ordinary shares.

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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."

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.

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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.

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. 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.

Fortissimo Capital is entitled to require that we conduct underwritten offerings under the U.S. Securities Act of 1933 with respect to the resale of its shares into the public markets. In addition, Amazon is also entitled to certain registration rights starting on January 10, 2018. 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, 2017, options to purchase 887,913 ordinary shares granted to employees and office holders were vested and exercisable and no 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, 2017 there were options to purchase 2,360,647 shares and 88,759 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.

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 discussed above, 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 2017 and we do not expect that we will be classified as a PFIC for the taxable year ending December 31, 2018. 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 2018 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."

The ongoing effects of the Tax Act and the refinement of provisional estimates could make our results difficult to predict.

Our effective tax rate may fluctuate in the future as a result of the recent United States tax law changes pursuant to H.R. 1, originally known as the 2017 Tax Cuts and Jobs Act, or the Tax Act, which was enacted on December 22, 2017. The Tax Act introduces significant changes to U.S. income tax law that will have a meaningful impact on our provision for income taxes. Accounting for the income tax effects of the Tax Act requires significant judgments and estimates in the interpretation and calculations of the provisions of the Tax Act.

Due to the timing of the enactment and the complexity involved in applying the provisions of the Tax Act, we made reasonable estimates of the effects and recorded provisional amounts in our financial statements for the year ended December 31, 2017. The U.S. Treasury Department, the Internal Revenue Service (IRS), and other standard-setting bodies may issue guidance on how the provisions of the Tax Act will be applied or otherwise administered that is different from our interpretation. As we collect and prepare necessary data, and interpret the Tax Act and any additional guidance issued by the IRS or other standard-setting bodies, we may make adjustments to the provisional amounts that could materially affect our financial position and results of operations as well as our effective tax rate in the period.

Certain U.S. holders of our common 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. Shareholder"). Generally, 10% U.S. Shareholders of a CFC are 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 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.

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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 negative 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.

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, 2017, we had 267 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.

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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 2018. 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 was 26.5% in 2015, 25% in 2016, 24% for 2017 and is currently set for 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."

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.

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 for purchase of property, plant and equipment and the digital direct to garment printing assets of SPSI Inc., were $2.9 million and $14.7 million in the years ended December 31, 2015 and 2016, respectively. Capital expenditures in the year ended December 31, 2017 included $5.7 million in property, plant and equipment. Our current capital expenditures relate primarily to investment in our new headquarters in the United States and in our manufacturing facility for our ink and other consumables in Kiryat Gat, Israel. We plan on financing these capital expenditures from cash on hand.

B. Business Overview

Industry

Overview

The global textile and garment industry, including textile, clothing, footwear and luxury fashion, was nearly $3 trillion in 2015 and is projected to grow between 2% and 5% annually through 2020, according to a 2016 Digital Textile Printing Industry Forecast 2015-2020 report by InfoTrends, a provider of market intelligence on the digital imaging industry. The global printed textile industry represents a sub-segment of the global textile industry. 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 the apparel and accessories, household, technical and display end markets.

There is a diverse ecosystem of businesses that utilize textile printing processes, such as custom decorators, online businesses, brand owners and contract printers. Custom decorators of varying sizes use their own manufacturing facilities to print promotional, sports, educational and souvenir products. In recent years the global retail market for apparel has transitioned to an online business model while brick and mortar “physical” stores have been constantly shutting down around the world. This trend, dubbed by many is a “retail meltdown” has led Credit Suisse to estimate that up to 25% of US shopping malls will be shut down by 2022. There is also an abundance of online businesses which use textile printing in a “produce to order” business model through online platforms that facilitate the rapid printing and shipping of customized and personalized goods to consumers. Brand owners typically use contract printers for textile production and printing and are increasingly aware of the benefits of various printing processes, which influences their choice of contract printer.

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We believe that the vast majority of the output of the global printed textile industry in 2016, which was projected to be approximately 32 to 33 billion square meters, was produced using analog print methods, specifically screen printing, carousels for printing on garments and rotary screen printers for printing on rolls of fabric. Our assessment is based on data provided in a 2016 report by Smithers Pira, a provider of market intelligence on the printed textile industry. The Pira report provides digital printing output estimates for 2016 and projects the analog printing output for 2016 as well as the annual digital textile printing growth rate through 2021, which we used to calculate a projected digital output of approximately 870 million square meters for 2016, representing 2.9% of total projected annual global printed textile output in 2016. According to the Pira report, initial growth rates in the digital textile printing market were more than 45% between 2004 and 2009, declining to an average CAGR of 25% between 2009 and 2012, an average CAGR of 18.8% between 2012 and 2014 and an average CAGR of 15.6% for 2014 to 2016 as the market became more mature and, in part, due to the impact of the global economic slowdown. Digital textile printing output is forecasted to grow at a 17.5% CAGR globally from 2016 to 2021 driven by projected CAGR over the same period of approximately 16.5% in North America, 15.0% in Western Europe, 13.5% in Eastern Europe and 20.1% in Asia according to the Pira report. Within digital textile printing, clothing applications represent the greatest amount of digital printed textile output and are projected to grow at a faster rate than household, technical and display applications.

We estimate that global revenue from digital textile printing equipment and ink will grow at a 15.7% CAGR between 2016 and 2021 based on the estimate of such revenue for 2016 and the projection for 2021, in each case, contained in the Pira report. There is currently a global installed base of approximately 42,000 digital textile printers.

Trends Impacting Digital Textile Printing

Evolving consumer behavior is driving the growth in digital printing as well as the shift to online retail. This behavior is motivated by increased demand for variety and complexity of images and designs as well as increased desire for customization and personalization. In order to distinguish themselves from the masses, consumers demand, and brand owners seek to supply, a wide range of styles that are innovative and diverse.

Apparel represents the largest segment of the online retail market and sales are highly influenced by rapidly changing consumer trends. We believe that several key trends are currently driving growth in both the online retail market and the demand for digital printing solutions:

Immediate Gratification. According to a 2017 report by Consumer Intelligence Research Partners, the number of Amazon customers in the United States willing to pay more in order to receive products faster, through its Amazon Prime service, stood at 90 million as of September 2017. This change in consumer behavior is causing retailers to evaluate ways to alter their approach towards inventory management in order to retain the business of discrete shoppers. In addition to retooling their internal fulfillment capabilities, many retail brands have begun to leverage the capacity of third party online stores in order to meet customer demands for delivery speed and product quality.

We believe that the industry will see an increase in proximity decoration, whereby traditional retailers will use more localized digital printing capacity in order to satisfy consumer demands.

Personal Expression. We believe consumers are increasingly seeking the ability to customize products by choosing preferred features from a menu of options, or the ability to personalize products by adding an individualized pattern. We believe this trend is driving a shift to digital printing and online retail in both our DTG and R2R end markets. While in the past personalization was primarily a result of individuals loading their own particular designs to be printed on garments, today shoppers can take advantage of web stores which offer huge variety of designs for which shoppers will pay a premium under the assumption that they will be unique when wearing such garment or at the very least be one of a few and not many.

Influence of Social Media. The means through which customers gather information to inform purchase decisions has also evolved in today's digital world. According to a study by PwC, 74% of consumers were influenced by social media in making online shopping decisions in 2017. We believe this trend further promotes the shift to the online retail channel. Personal expression today is also associated with subscribing to certain interest groups which promote ideas, concepts, designs, etc. Such affiliation drives significant on demand printing, many times creating short term huge surges in demand

Consumer Preference. Today's consumer is leveraging the online channel for apparel purchases at a pace that far exceeds traditional brick and mortar purchases. According to a report by Internet Retailer, the online channel represented 30.0% of U.S. apparel sales in 2017, up from 17.0% in 2015. The market share gain corresponds to apparel revenue growth of 19.7% in the online channel and only 1.1% growth in the brick and mortar channel. We believe our installed base reflects the convergence of the growth in online apparel retail and the growth in digital printing.

Sustainability. Shoppers are constantly becoming more conscious of environmental impact of what they consume. The textile production market is notorious for pollution and negative impact on the environment. Our proprietary process of digital printing is more eco-friendly than current analog printing and as such can win the favor of shoppers to whom environmental impact is a priority.

Proximity decoration. Retailers and apparel manufacturers need to respond quickly to daily changes in market trends coupled with the move to same or next day delivery cycle times. This has precipitated a move to proximity decoration, whereby digital printers, which have no environmental footprint, are placed in densely populated areas to execute demand of online shoppers.

New business models have developed in response to the evolution of these 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 a variety of content creators. The ecosystem of web-to-print businesses which we currently serve includes

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

Hybrid Printers. Companies who 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. Demand for these businesses is typically generated online through other web retailers.

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

The following characteristics of digital textile printing have enabled these new business models and 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 small runs, with personalization capabilities, in a cost-effective manner with a minimum order quantity of one unit.

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.

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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.

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 reduction in working capital requirements has enabled the emergence of numerous online businesses which are focused on the sales 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 process 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.

Ability to fulfill orders on one by one basis. 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 particular design before printing.

In addition to these consumer driven trends, the textile printing industry is being impacted by environmental considerations. Regulatory bodies and consumers are increasingly focused on social responsibility and eco-friendly manufacturing, demanding that custom decorators, online businesses, brand owners and contract printers reduce the negative environmental impact of textile treatment and dyeing, which represents a significant portion of total industrial waste water. 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.

Overview of Textile Printing Processes

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

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Analog 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:

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 chart 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.

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The following chart depicts the automated carousel screen printing process:

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.

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:

Roll-to-Roll (R2R). In R2R 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 R2R 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.

Business

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, direct-to-garment, or DTG, and roll-to-roll, or R2R, 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. 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 printed textile industry.

There are a number of trends within the global printed textile industry that we believe are driving greater demand for our solutions. Consumers are continuing to seek to differentiate themselves by wearing customized and personalized garments with colorful and intricate images and designs. Consumers are also increasingly purchasing retail products online, with apparel representing the largest portion of this market. Brand owners and contract printers are seeking methods to shorten time to market and reduce production lead times in order to more efficiently and cost-effectively produce smaller runs of printed textiles and reduce the risk of excess inventory while concurrently meeting consumer demands. As consumers increasingly shift to online retail channels, there is an increased need for brand owners and contract printers to improve efficiency, as consumers demand more varied product offerings and faster fulfillment of orders. Simultaneously, regulatory bodies and consumers are increasingly focused on social responsibility and eco-friendly manufacturing, demanding that printed textile manufacturers reduce the negative environmental impact associated with the manufacturing of printed textiles. Our solutions address these trends by enabling our customers to print smaller quantities of customized products in a time efficient, cost-effective and environmentally friendly manner, effectively allowing them to transition from customary methods of supply and demand to demand and supply, a model by which decoration of fabric only takes place once a customer order has been issued.

The success of online apparel retail is dependent heavily on the ability to show large variety of designs. Since it is difficult to predict shopping preference, it is increasingly difficult to stock every possible design. Unlike the physical experience of shopping at a brick and mortar store, where a sales person has the opportunity to influence our buying decisions, we are free to move from one website to another with the simplicity of a mouse click. Online stores are concerned with the possibility that certain selected items not be in stock or carry a long lead time as such response will most likely lead a shopper to “churn” to another website. Having digital capacity available allows printers to offer unlimited design with minimal to no inventory risk and we believe we are well positioned to take advantage of this trend.

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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. With throughputs ranging from 32 to 250 garments per hour, our entry level and high throughput DTG solutions are suited to the needs of a variety of customers, from smaller commercial operators with limited budgets to mass producers with mature operations and 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 workflows in the printing process, by offering a complete solution from web order intake through graphic job preparation and execution. We also offer customers maintenance and support services as well as value added services aimed at optimizing the use of our systems.

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 R2R market. While the DTG market generally involves printing on finished garments, the R2R 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 R2R digital textile printing solution available on the market. 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 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, 2017, had over 1,100 customers globally. As of December 31, 2017, we had 412 employees located across four regions: Israel, the United States, Europe and the Asia Pacific region. In the year ended December 31, 2017, we generated revenues of $114.1 million, representing an increase of 5.0% over the prior fiscal year. In the year ended December 31, 2017, we generated 53.1% of our revenues from the Americas, 8.1% from EMEA, 14.1% from the Asia Pacific and 4.7% from other regions.

Our Competitive Strengths

The following are our key competitive strengths:

Leading player in fast-growing digital DTG market. We are a leading player in the fast-growing digital DTG market based on our sales and have over 1,100 customers globally. We estimate that global revenue from digital textile printing equipment and ink will grow at a 15.7% CAGR between 2016 and 2021 based on the estimate of such revenue for 2016 and the projection for 2021, in each case, contained in the Pira report. In 2016, we grew our revenues 25.8% compared to 2015 and, in 2017, we grew our revenues 5% compared to 2016. We believe that high throughput DTG applications in the textile printing market are positioned to grow at a rate greater than the 15.7% overall industry growth rate projected between 2016 and 2021. We have outperformed the industry growth rate over the past several years, growing our revenue at a 26.7% CAGR from the 12 months ended June 30, 2014 to the 12 months ended June 30, 2016, versus an industry CAGR of 15.6% for the same period, as estimated in the Pira report. The Pira report estimates that the DTG market has an addressable opportunity of six to 10 billion garments a year. According to a prior Smithers Pira report published in 2014, over 300,000 sites globally print primarily t-shirts and other apparel.

Well positioned to disrupt the R2R market with our unique single-step manufacturing solution. We believe we are well positioned to capitalize on the growing trend toward customized home décor with our unique R2R 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 don’t have a vertically integrated textile mill. Unlike other digital textile printers, the Allegro does not require multiple pre-processing and post-processing steps which are customarily used in vertically integrated textile mills and which 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 and 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 R2R digital printing require dedication of discrete printers to specific fabric types.

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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 models by enabling them to produce short to medium runs of high-quality customized garments efficiently. This also facilitates “web to print” business models that manufacture on a “produce to order” basis and allows brand owners to produce garments in house. With a constantly growing worldwide customer base of over 1,100 customers, we are witnessing the creation of a global fulfillment network of printing specialists which 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 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 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 246as of December 31, 2017 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, 2017. We anticipate revenue from services to increase over time as we reach upgrade cycles across our growing installed base. Additionally, sales of ink and other consumables are generally higher in high throughput systems such as the Vulcan, Avalanche and Allegro systems. Large accounts typically run at high utilization rates and can consume up to five times as much ink per year compared to other accounts. 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.

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 25 issued patents and 22 provisional or pending US applications, 27 pending non-US patent applications and 10 pending PCT applications that cover wet-on-wet printing methodology, ink formulations, printing processes and related methods and systems. Our team of over 122 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 mature operations and complex needs. Since 2015, we have commercialized two new solutions in the market: the Allegro, a one-step, integrated R2R printing, drying and curing system, and the Vulcan, a cost-effective digital substitution for carousel screen printing. 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.

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Taking advantage of a digital revolution. 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 and shorter runs of production.

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 capacity.

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, Gabi Seligsohn, and our Chief Financial Officer, Guy Avidan, bring extensive experience of managing publicly traded companies. Our management team’s industry expertise, history with our company and extensive experience in running global publicly traded 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 organizations including Intel, HP, KLA Tencor and Stratasys. Over the past three years, we have also invested heavily in human resources to support our growth. Since 2013, our workforce has more than doubled from 190 to 412 as of December 31, 2017. Additionally, more than 150 of our employees are in the field, enabling us to provide more localized service for our customers.

Our Strategy

The following are the key elements of our growth strategy:

Increase sales to 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 services, selling systems from our additional product families and enabling our customers to increase utilization of systems by improving productivity and reliability. 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 direct sales and marketing teams and application development professionals play an active role in customer education and this referral process. Our objective is to help customers operate their businesses more efficiently and to increase utilization of their systems, thereby requiring more ink and other consumables purchases as well as potential investment in new systems as our customers require additional capacity.

Acquire new high volume customers. Our technology is ideally positioned to enable business models focused on mass customization and personalization. We plan to continue growing our customer base by targeting customers with growth business models and demand for our high throughput solutions, including multiple systems or fleets of our systems. An example of this strategy is the Master Purchase Agreement, signed 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. During the years 2016 and 2017, Amazon related revenues were $17.9 million and $14.4 million, respectively. We expect that our relationship with Amazon will continue to expand in the future and that they will remain a significant customer.

Capitalize on growth in our targeted markets. Evolving consumer behavior is driving the growth in digital printing as well as the shift to online retail. Since the online shopping experience relies heavily on the display of large varieties of designs as well as short cycle times from order to delivery, webstores are faced with a need to carefully manage inventories, which requires the new paradigm of demand and supply. Our solutions enable our customers to print in smaller, customized quantities in a time efficient, cost-effective and environmentally-friendly manner, effectively leading them to move from customary methods of supply and demand to this new paradigm. Digital textile printing allows retailers to establish new fulfillment centers (or re-task existing ones) in different parts of the world to support consumers' demand for variety, while shortening lead times from order to delivery and protecting against excess or obsolete inventory risks. With over 1,100 customers globally, many of which operate as fulfillment centers, we believe we are well positioned to play an enabling role for this trend. Our high throughput systems and proprietary inks ensure replicable quality and maximum uptime, which in turn, allow our customers to address the demands of online retail. We will continue tailoring our solutions to meet the needs of our customers in this evolving consumer environment through the ongoing development of our technology and the continued investment in the development of new ink formulas for our systems in order to expand the range of fabrics on which we can print and further improve the quality of our high resolution images and designs.

Extend our serviceable addressable market (SAM) by continuing to enhance our solutions. We will continue to expand our SAM as we introduce 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 are also continuing to drive adoption of digital DTG printing solutions by customers who primarily use screen printing carousels, which is how the majority of DTG printing jobs are currently performed. While we have started to penetrate this market by offering standalone DTG solutions, such as our Avalanche and Storm II systems, we plan to deepen our penetration and further transition users of these analog systems to digital printing technologies through our Vulcan system. Given Vulcan's ease of setup, lower cost per print, and high throughput levels, we are seeking to disrupt the core screen printed textile industry and target replacement of a significant installed base of automated carousels. We have also begun to expand our SAM by selectively targeting the digital R2R market through our Allegro system, which offers customers the ability to produce limited quantity orders with a high degree of variety and uniquely supports multiple fabric types in a single-step R2R printing process. We believe that our technology portfolio and the industry expertise of our employees and partners will allow us to continue to deliver a broad base of textile solutions to our customers that meet the challenges of printing on textile substrates. Continuing to respond to these challenges will enable us to further expand our SAM as we produce higher quality prints on a wider set of fabrics. This will enable us to expand into areas such as the $97 billion "athleisure" market, where clothing designed for workouts and other athletic activities is worn in other settings.

Extend our leadership position through ongoing investments in research and development, acquisitions and strategic partnerships. We seek to continue to differentiate ourselves and extend our leadership position by investing in research and development, acquisitions and strategic partnerships. We intend to leverage our customer relationships to identify emerging industry needs and innovate and develop new intellectual property and applications that address those needs. We are also developing new systems and intend to develop and introduce additional systems in the future. From time to time, we may also supplement our internal efforts with complementary inorganic initiatives such as acquisitions and strategic partnerships in order to enhance our positioning. For example, our acquisition of Polymeric Imaging in 2015 expanded our ink technology capabilities, and our acquisition of the digital DTG printing assets of SPSI in 2016 enabled us to strengthen our sales channel and gain access to a large screen printing customer base that we can now target for sales of digital solutions. 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. In an effort to better inform current and prospective customers about the capabilities of our solutions, we have also made investments in our direct sales and marketing teams and application development professionals.

Our Systems

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, number of print heads, printing throughput and process ink colors, as well as other customizable features. We categorize our DTG systems into two groups that are focused on the industrial segment of the DTG market: entry level and high throughput. As our business and marketplace has evolved, we have shifted the mix of our system sales primarily to high throughput systems.

Entry Level. 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 Direct to Garment. We offer a wide range of high throughput systems. We market a hybrid platform, the Paradigm II, which connects to existing screen printing carousels for customers who want to combine short runs of multicolor images into their ongoing screen printing operations. 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 also 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, 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.

Direct to Garment Mass Production. During 2016, we successfully commercially launched our new high throughput platform, the Vulcan which is geared towards addressing the needs of mass production at a significantly lower cost per print relative to our other systems.

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.

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Our Vulcan system is designed to enable mass production of customized garments with high and consistent printing quality. It is designed to run at throughputs higher than any of our existing systems. The system's architecture takes a different ergonomic approach to the sequence of loading and unloading of garments than that of our existing systems, enabling higher throughputs. The system utilizes state of the art print head technology and specially designed inks which allow for significant reduction in cost per print due to an increase in color intensity which allows for use of less ink per printed area as well as a reduction in wasted ink as a result of a transition to recirculating print heads. We achieved initial sales of Vulcan in the fourth quarter of 2016. Given the Vulcan's ease of setup and high throughput levels, we are seeking to disrupt the core screen printed textile industry and target replacement of a significant installed base of automated carousels. The Vulcan also capitalizes on our advanced print head and ink technology to limit waste, allowing for installation in locations where carousels cannot be installed due to environmental, health and safety laws and regulations.

Our Allegro system is the first R2R printing system to allow for one-step R2R 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, all other R2R 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. 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 $60,000 to over $800,000 and consume an average of $5,000 to $300,000 of ink and consumables annually per system.

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, lycra and denim 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 $97 billion athleisure market.

System	Target Customer	**Effective Throughput 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 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
Paradigm II	High Throughput	120/120	CMYK	15.5 x 19.5 in
Vulcan	High Throughput	250/250	CMYKRG + White	28 x 39 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.

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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 ten 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 near 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.

Software Solutions

All of 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.

Many of our customers also purchase our QuickP Designer standalone 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.

We also offer our QuickP Plus 2.0 software suite, which provides customers with a full workflow solution from design creation and acceptance of job orders through production and order management.

In an effort to continually increase our customers' productivity and ease of use, we initiated several collaborative efforts during 2017 with a few software companies. For example, we entered into a collaboration with Custom Gateway. As part of this collaboration, Custom Gateway provides a framework for enabling mass customization and on demand fulfilment and enables Kornit's customers to sell customizable products online. We have also collaborated with ColorGate, which provides a professional RIP solution for our systems, allowing Kornit's customers to gain both an outstanding print output and an optimized workflow experience.

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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, 2017, we had service contracts in place with approximately 13% of our installed base. Service revenues exceeded 10% of our overall revenues for the first time in 2017 and amounted to $12.1 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. During 2016, we began to introduce hardware and software upgrades to our existing systems.

Maintenance and Support

We typically provide a one-year warranty on our systems, which covers parts, labor and remote support. Our customers can also purchase an additional year of warranty 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, software upgrades and onsite yearly maintenance or they can choose to rely on our support on a non-contractual time and material basis. In the United States, we provide maintenance and support directly to our customers. In EMEA, 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. Some of our printing systems include mandatory second year warranty which secures services revenue and ensures long terms relationship with our customers.

Professional Services

Our systems are designed such that customers can operate them without our assistance or that of 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 provide professional services to customers in all regions both in person and through advanced web based learning systems.

Our Customers

Our diverse global customer base consisted of over 1,100 customers as of December 31, 2017.

Throughout our growing installed base, our customers are able to 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 which we currently serve includes:

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

Hybrid Printers. Companies who 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.”

Sales and Distribution

Our go to market strategy consists of a hybrid model of indirect and direct sales. We generate 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. Some of our independent distributors have our systems available for tradeshows, product demonstrations at their facilities, and other promotional activities. As of December 31, 2017, our global network of channel partners consisted of approximately 70 independent distributors and resellers. Sales by our distributors accounted for approximately 49% of our revenues in 2017, approximately 47% of our revenues in 2016 and approximately 64% in 2015. In addition to working closely with our channel partners, our direct sales force engages in direct sales in certain geographies, and also with our largest customers, irrespective of their location. We continually evaluate our go to market strategy in the geographies we serve in an effort to best serve our direct or indirect customers. As our roadmap continues to evolve, the sophistication of our systems and our selling prices will require us to continue to advance the capabilities of our sales and marketing teams as well as those of our distributors.

A substantial portion of our sales in North America are performed through independent distributors. Hirsch International Corporation and SPSI, Inc. were our top two independent distributors by revenues in 2015 and 2016, accounting for 18% and 21% of our revenues in each such period in the case of Hirsch, and 15% and 7% of our revenues in each such period in the case of SPSI. Hirsch was our top independent distributor in 2017, accounting for 18% of our revenues. We entered into a distributor agreement with Hirsch, dated April 1, 2014, with an initial term of three years, which renews automatically for successive one-year periods unless one party notifies the other party that it does not wish to renew the agreement, by providing 90 days’ notice prior to the end of the initial term of renewal period, as applicable. The agreement renewed automatically in April 2017. Our agreement with Hirsch is a non-exclusive distribution contract across North America, including 28 states concentrated on the East and West Coasts of the United States, as well as five Canadian provinces. We maintain projected sales plans for a number of different systems on a yearly basis and there is a minimum yearly sales requirement for systems and ink and other consumables.

In July 2016 we acquired the digital direct to garment printing assets of SPSI. We had been partners with SPSI since 2004 and our agreement with SPSI was previously a non-exclusive distribution contract across the United States, including 20 states mainly in the Midwest, Northwest and Southwest regions. The decision to acquire the SPSI assets was made in light of the fact that the territory covered by SPSI had an increasing number of larger accounts which required a more direct relationship with such customers. By fostering direct relationships with these customers, we aim to deepen our technical relationship with them as well better align our product roadmap to meet their needs. Through the acquisition we attained access to over 5,000 screen printing customers of SPSI, who represent a market opportunity for us to potentially provide systems that will facilitate their transition to digital printing. During 2017, we increased our sales headcount in the United States and split the region into three sub-territories in order to increase our presence in the market. We also signed on two new distributors for the United States. As part of this effort we also decided to transition our US headquarters to New Jersey.

Marketing

Our marketing strategy is aimed at positioning us as a global leader in digital textile printing. We are focused on increasing awareness of our brand and communicating the benefits of our disruptive technology and how it addresses market needs in order to develop leads and increase sales to existing customers. We market our systems as a comprehensive solution to the growing trend towards mass customization and personalization. We seek to execute our strategy by leveraging a combination of internal marketing professionals and a network of channel partners to communicate the value proposition and differentiation of our systems, generating qualified leads for our direct sales force and channel partners. By investing in analytics-driven lead development and through detailed interactions with key customers, we seek to create and update our product roadmaps and individual marketing plans to optimize distribution while helping facilitate the process of release, ramp-up and sales.

We use a variety of advanced inbound and outbound online marketing methods to reach and communicate with potential customers. Inbound methods include a variety of online marketing strategies comprised of search marketing (for example, search engine optimization and pay per click advertising), social media, blogs, syndication, webinars and white papers. Outbound channels include a fully automated e-mailer and web based customer nurturing and scoring process, as well as more traditional marketing methods such as print advertisements, direct mail and e-mail, tradeshows, newsletters and referrals. In addition, we have developed domestic and international onsite demonstration capabilities in our regional offices in the United States, Germany, Hong Kong and China and we also rely on demonstration facilities setup by our channel partners.

Manufacturing, Inventory and Suppliers

Manufacturing

Our systems are currently assembled by Flex Ltd., or Flex, at its facilities in Yavne, Israel and ITS Industrial Techno-logic Solutions Ltd., or ITS, at its facilities in Rosh Ha'Ayin, Israel. Aside from our print heads, we source many of the components of our systems directly, which we believe allows us to manage our material costs and take advantage of the overall volume of systems manufactured at both facilities without the overhead of having in house manufacturing.

We entered into a manufacturing services agreement with Flex in May 2015, pursuant to which Flex manufactures our Avalanche, Storm, Breeze and Paradigm II systems and also manufactures our Vulcan system on a full turnkey basis in accordance with our bill of materials, drawings and designs. The initial term of the agreement is three years and it renews automatically for additional periods of 24 months unless notice of termination is given by either party at least 180 days prior to the end of the initial term or a renewal term. The agreement was automatically renewed in May 2017 for an addition 24-month period. We can terminate the agreement at any time upon 180 days' notice and Flex may terminate the agreement at any time upon 365 days' notice. Prices are set in advance for periods of 18 months but are subject to change based on certain enumerated circumstances set forth in the agreement or as agreed between Flex and us.

Our agreement with ITS for manufacture of certain of our systems terminated in November 2017. We are currently negotiating with ITS on an agreement pursuant to which ITS will continue to provide manufacturing services for one of our systems for a limited time.

We entered into a letter of agreement with Sanmina SCI-Israel Medical Systems Ltd. on September 7, 2017, pursuant to which Sanmina will manufacture, assemble, test, inspect configure and ship our products. The letter of agreement is in effect for a period of six months and thereafter it shall be renewed automatically for additional 90 days, unless one party provides the other with 30 days' notice before the automatic renewal date. The parties are negotiating the terms of a binding agreement.

We produce and bottle our ink and other consumables at our facility in Kiryat Gat, Israel using raw materials purchased from various suppliers for milling pigments and mixing, bottling and packaging.

Inventory and Suppliers

We purchase our print heads from FujiFilm Dimatix, Inc., or FDMX, and then customize them at our Kiryat Gat, Israel facility, for optimal use in our systems. We maintain an inventory of parts to facilitate the timely assembly of our systems and for servicing our installed base. Most components are available from multiple suppliers, although certain components used in our systems and consumables are only available from single or limited sources.

We first entered into an agreement with FDMX in 2006. In December 2015, we entered into a new agreement with FDMX. Pursuant to this agreement, FDMX sells us print heads and additional by-products. Under the agreement, we are entitled to sell, lease and use the FDMX products and components subject to certain limitations, including the use of FDMX products or components for applications other than printing images and designs on textiles, reselling print heads other than as integral components of our systems, or as spare or replacement parts, and distributing in markets reserved by FDMX. The agreement with FDMX also provides that we are required to make an additional semi-annual payment to FDMX based on the amount of inks, other than inks and other consumables sold by FDMX, that we sell over a relevant period or, if we do not sell ink and other consumables, a payment based on sales of our systems. We have granted customary audit rights to FDMX to verify the amount of sales that we make. 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. Our current agreement terminates in December 2019 and provides for one three-year renewal period and 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's 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 BG Bond. 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 other inks, this chemical is supplied by The Dow Chemical Corporation, a large multinational manufacturer of chemicals. We currently purchase the chemical from The Dow Chemical Corporation on a purchase order basis.

A component of our some of our systems is supplied by a sole supplier, Adelco Screen Process Ltd. We currently purchase this component on a purchase order basis.

We consider our single and limited-source suppliers to be reliable, but the loss of any one of these suppliers could result in the delay of the manufacture and delivery of our systems. In order to minimize the risk of any impact from a disruption or discontinuation in the supply of print heads, emulsion or components from limited source suppliers, we maintain an additional inventory of such components. Nevertheless, such inventory may not be sufficient to enable us to continue supplying our products during the period that may be required to locate and qualify a new supplier. See "Risk Factors — If our relationships with suppliers, especially with single source suppliers of components, were to terminate, our business could be harmed."

Research and Development

We believe that continued investment in research and development is important to position us as a global leader in digital textile printing. We conduct our research and development activities in Israel and we believe this provides us with access to world-class engineers and chemists. Our research and development efforts are focused on improving and enhancing our existing systems and services, as well as developing new systems, software, features and functionality. We are also focused on enhancing our current DTG systems with new features and functionality, improving system reliability and uptime and making our systems even more user-friendly, and investing in new chemistry for broadening our span of applications. Our research and development expenses were $12.0 million, $17.4 million and $20.8 million in the years ended December 31, 2015, 2016 and 2017, respectively.

Intellectual Property

We consider our proprietary technology to be important to the development, manufacture, and sale of our systems and seek to protect such technology through a combination of patents, trade secrets, confidentiality agreements and other contractual arrangements with our employees, consultants, customers and manufacturers.

As of December 31, 2017, we owned fourteen issued patents in the United States and twenty-two provisional or pending U.S. patent applications. We also had eleven patents issued in non-U.S. jurisdictions, along with twenty-seven pending non-U.S. applications, and have ten 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 and India. The principal granted patents relate to our wet-on-wet printing methodology, ink formulations, printing processes and related methods and systems, with expiration dates ranging from 2020 to 2035.

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We enter into confidentiality agreements with our employees, consultants, channel partners, customers and manufacturers and limit internal and external access to, and distribution of, our 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.

In addition, we own the registered trademarks "KORNIT," "NEOPIGMENT" and the "K" logo, in numerous jurisdictions and make use of a number of additional unregistered trademarks.

There can be no assurance that our patents or other intellectual property rights will afford us a meaningful competitive advantage. We believe that our success depends primarily on our research and development, marketing, business development, applications know-how and service support teams and application experts as well as our ongoing relationships with our large customer base. Accordingly, we believe that the expiration or termination of any of our patents or patent licenses, or the failure of any of our patent applications to result in an issued patent, would not have a material adverse effect on our business or financial position.

Competition

Textile printing is most commonly conducted using automated carousel screen printing. In recent years, manufacturers of digital printers have increased their penetration of this market. As such, we compete with companies that manufacture automated carousel screen printers as well as those that manufacture digital printers. Our principal competitor in the high throughput digital DTG market is Aeoon Technologies GmbH. We also face competition from Brother International Corporation, Seiko Epson Corporation and a number of smaller competitors with respect to our entry level systems. Our technologies allow us to offer a wide spectrum of digital textile printing systems of varying features, capacities and price points. We believe that this strategy will enable us to effectively compete with the other textile printer and ink manufacturers in the digital DTG market.

Within the R2R market, we continue to see conversion from rotary screen printing to digital printing, as high throughput digital R2R systems are now increasingly capable of printing complex, customized images and designs. Our competitors in the R2R market include Dover Corporation, through its MS Printing Solutions S.r.l. subsidiary, Durst Phototechnik AG, Electronics for Imaging, Inc., through its Reggiani Macchine SpA subsidiary, Mimaki Engineering Co., Ltd., and a number of smaller competitors. Our digital R2R solutions offer customers the ability to produce limited quantity orders, with a high degree of variety, and allow us to uniquely support multiple fabric types in a single step R2R printing process, whereas competitive solutions require multiple pre-processing and post-processing steps. We believe our differentiated, end-to-end solutions will enable us to effectively compete with other textile printer and ink manufacturers in the digital R2R market.

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, Plants and Equipment

Our corporate headquarters are located in Rosh Ha'Ayin, Israel in an office and research and development facility consisting of approximately 82,000 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 15,000 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 is currently expected to begin in 2019 and 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 U.S. offices are located in Mequon, Wisconsin, consisting of approximately 12,000 square feet. The lease for this office expires in June 2018. We intend to relocate our US offices to Englewood, New Jersey. We have entered into a lease for our new headquarters in the United States, which is comprised of approximately 15,845 square feet of offices and warehouse expiring in February 2028. The lease for this location expires in February 2028. We intend to maintain a smaller office in Mequon following such relocation. We maintain additional sales, support and marketing offices in Dusseldorf, Hong Kong, Shanghai and Florida.

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, 2017 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 R2R 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.

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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 R2R market. While the DTG market generally involves printing on finished garments, the R2R 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. We generate 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.

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, 2017, we had 412 employees located across four regions: Israel, the United States, 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, 2015, 2016 and 2017 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 consumable. 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.

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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 sell our products directly and through independent distributors who resell them to customers. Sales by our distributors accounted for approximately 47% of our revenues in 2016 and approximately 49% of our revenues during 2017. 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, however, our direct sales decreased in 2017 as we strengthened our relationships with our distributors and added more distributors in the United States.

We recognize revenues from sales of our systems upon delivery, provided that all other revenue recognition criteria are met. In respect of sale of systems with installation and training, we consider the installation and training to be not essential to the functionality of the systems. Therefore, we recognize the revenues upon delivery in accordance with the agreed-upon delivery terms once all other revenue recognition criteria have been met. Revenues from provision of value added services are generally recognized at the time such support services are provided.

We periodically provide customer incentive programs including product discounts, volume-based rebates and warrants, which are accounted for as reductions to 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:

	2015			2016			2017		
	$	%		$	%		$	%	
	(in thousands except percentages)								
U.S.	$42,528	52.7	%	$63,656	58.6	%	$60,541	53.1	%
EMEA	21,600	25.0		24,720	22.7		32,015	28.1	

Asia Pacific	16,042	18.6	11,963	11.0	16,092	14.1
Other	3,235	3.7	8,355	7.7	5,440	4.7
Total revenues	$86,405	100.0%	$108,694	100.0%	$114,088	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 standalone 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 three 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 R2R 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 as a part of strengthening our relationships with our distributors.

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 (expenses), Net

Finance income (expenses), 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, 2017, 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 26.5% in 2015, 25% in 2016 and 24% in 2017. The corporate tax rate decreased to 23% beginning on January 1, 2018. 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 2015, 2016 or 2017 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.

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Comparison of Period to Period Results of Operations

	Year Ended December 31,		
	2015	2016	2017
	(in thousands)		
Revenues			
Products	$79,751	$100,818	$101,953
Services	6,654	7,876	12,135
Total revenues	86,405	108,694	114,088
Cost of revenues			
Products	35,632	46,483	46,480
Services	10,188	12,801	13,497
Total cost of revenues	45,820	59,284	59,977
Gross profit	40,585	49,410	54,111
Operating expenses:			
Research and development	11,950	17,383	20,834
Sales and marketing	13,367	18,338	21,279
General and administrative	9,500	12,259	13,578
Restructuring expenses	-	-	503
Total operating expenses	34,817	47,980	56.194
Operating income (loss)	5,768	1,430	(2,083)
Finance income (expenses), net	(334)	46	452
Income (loss) before taxes on income	5,434	1,476	(1,631)
Taxes on income	709	648	384
Net income (loss)	$4,725	$828	$(2,015)

	Year Ended December 31,		
	2015	2016	2017
	(as a % of revenues)		
Revenues			
Products	92.3%	92.8%	89.4%
Services	7.7	7.2	10.6
Total revenues	100	100	100
Cost of revenues			
Products	41.2	42.7	40.8
Services	11.8	11.8	11.8
Total cost of revenues	53.0	54.5	52.6
Gross profit	47.0	45.5	47.4
Operating expenses:			
Research and development	13.8	16.0	18.3
Sales and marketing	15.5	16.9	18.7
General and administrative	11.0	11.2	11.9
Restructuring expenses	-	-	0.4

Total operating expenses	40.3	44.1	49.3
Operating income (loss)	6.7	1.3	(1.8)
Finance income (expenses), net	(0.4)	0.0	0.4
Income (loss) before taxes on income	6.3	1.4	(1.4)
Taxes on income	0.8	0.6	0.3
Net income (loss)	5.5 %	0.8 %	(1.8)%

Comparison of the Years Ended December 31, 2016 and 2017

Revenues

Revenues increased by $5.4 million, or 5.0%, to $114.1 million in 2017, which is net of $2.9 million fair value of the warrants associated with revenues recognized from Amazon, from $108.7 million in 2016, which is net of $2.0 million fair value of the warrants associated with revenues recognized from Amazon. The growth in revenues resulted from a 20.1% increase in ink and other consumables revenues to $51.5 million in 2017 from $42.8 million in 2016, a 54.1% increase in service revenues to $12.1 million in 2017 from $7.9 million in 2016 and a decrease of 12.9% in systems revenues from $58.0 million in 2016 to $50.5 million in 2017. The $8.7 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 $7.5 million decrease in systems revenues was attributable to lower system sales in 2017,particularly in North America, with a significant impact coming from the delay in receipt of permits for a new site for one of our large customers in the US as well as longer sales cycle s for our Vulcan platform. 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.

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Cost of Revenues and Gross Profit

Cost of revenues increased by $0.7 million, or 1.2%, to $60.0 million in 2017 from $59.3 million in 2016. Gross profit increased by $4.7 million, or 9.5%, to $54.1 million in 2017, as compared to $49.4 million in 2016. Gross margin was 47.4% in 2017 compared to 45.5% in 2016. Gross margin increased as a result of the shift in mix of revenues in favor of ink and consumables, which have a relatively higher gross margin percentage, from 39.4% of revenues in 2016 to 45.1% of revenues in 2017. The increase was also related to an increase in ink and consumables gross margin which resulted from economies of scale and increased ink and consumables sales and an increase in services gross margin which resulted from an increase in sales of systems upgrades to our wider install base and an increase in sales of service contracts. Such positive impact was offset by a decrease in systems gross margin which resulted from lower systems sales in 2017 compared to 2016.

Operating Expenses

	Year Ended December 31,							
	2016			2017			Change	
	Amount	% of Revenues		Amount	% of Revenues		Amount	%
				($ in thousands)				
Operating expenses:								
Research and development	$17,383	16.0	%	$20,834	18.3		3,451	19.9%
Sales and marketing	18,338	16.9		21,279	18.7		2,941	16.0
General and administrative	12,259	11.3		13,578	11.9		1,319	10.8
Restructuring expenses	-	-		503	0.4		503	100
Total operating expenses	$47,980	44.2	%	$56,194	49.3		8,214	17.1%

Research and Development. Research and development expenses increased by 19.9% in 2017 compared to 2016. This resulted primarily from an increase of $1.8 million in salaries and related personnel expenses and share based compensation due to the hiring of additional personnel in 2017 reflecting an increase in headcount compared to 2016, an increase of $1.6 million in costs due to increased research and development activity, which primarily includes $0.6 million in facilities costs in connection with the expansion of our headquarters in Rosh Ha'Ayin, Israel, and an increase of $1.0 million in expenses due to depreciation expenses relating to leasehold improvements made and capital equipment acquired as part of the expansion of our research and development capabilities. As a percentage of total revenues, our research and development expenses increased during this period from 16.0% in 2016 to 18.3% in 2017.

Sales and Marketing. Sales and marketing expenses increased by 16.0% in 2017 compared to 2016. This increase was primarily due to an increase of $2.3 million in salaries and related personnel expenses and share based compensation expenses mainly due to a higher average number of employees during 2017 compared to 2016, higher cost per employee in 2017 increase in sales commission, and increase of $1.0 million in amortization of assets due to the purchase of the digital direct to garment printing assets of SPSI in 2016. As a percentage of total revenues, our sales and marketing expenses increased during this period from 16.9% in 2016 to 18.7% in 2017.

General and Administrative. General and administrative expenses increased by 10.8% in 2017 compared to 2016. This resulted primarily from an increase of $1.9 million in salaries and related personnel expenses and share based compensation mainly due to the hiring of additional personnel reflecting an increase in headcount, an increase of $0.3 million in expenses related to upgrades of our IT infrastructure and an increase of $0.2 million of facilities costs due to expansion of our facilities. These increases were offset by a decrease of $0.5 million in acquisition related expense that occurred in 2016. As a percentage of total revenues, our general and administrative expenses increased from 11.3% in 2016 to 11.9% in 2017.

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Restructuring Costs. During 2017, we determined to transition our US headquarters to New Jersey. As part of this transition, we entered into agreements with certain employees for early retirement or retention. We recorded an expense of $0.5 million in 2017.

Finance Income (Expenses), Net

Finance income (expenses), net reflected income of $0.05 million in 2016 and an expense of $0.5 million in 2017. This change resulted primarily from the effects of exchange rates on our non-dollar denominated financial assets, specifically the exchange rate of the U.S. dollar to the NIS offset by interest accrued and received with respect to our cash investments and marketable securities in 2017.

Taxes on Income

Taxes on income decreased slightly from $0.6 million in 2016 to $0.4 million in 2017. The decrease is consisted of an increase in current tax in 2017 and a one-time expense for the change in deferred taxes in the U.S due to the new tax reform offset by the reversal of an accounting provision in the amount of $0.6 million.

Comparison of the Years Ended December 31, 2015 and 2016

Revenues

Revenues increased by $22.3 million, or 25.8%, to $108.7 million in 2016 from $86.4 million in 2015. The growth in revenues resulted from a 27.2% increase in systems and services revenues to $65.9 million in 2016 from $51.8 million in 2015 and a 23.8% increase in sales of ink and other consumables to $42.8 million in 2016 from $34.6 million in 2015. The $14.1 million growth in systems and services revenues was attributable to a change in the mix of systems sold, specifically sales of higher throughput systems, which sell for higher average selling prices than our entry level systems, in 2016 compared to 2015. We believe that the increase in sales of high throughput systems was a result of the growing maturity of the web-to-print business model which calls for high throughput systems to meet the growing consumer demand. The $8.2 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 improvements in system and services revenues and ink and consumables revenues was offset by the fair value of warrants associated with revenues recognized from Amazon of $2.0 million.

Cost of Revenues and Gross Profit

Cost of revenues increased by $13.5 million, or 29.4%, to $59.3 million in 2016 from $45.8 million in 2015. Gross profit increased by $8.8 million, or 21.7%, to $49.4 million in 2016, as compared to $40.6 million in 2015. Gross margin was 45.5% in 2016 compared to 47.0% in 2015. The decrease in gross margin is related to an increase in systems and services gross margin which resulted from an increase in sales of higher margin high throughput systems, economies of scale and an increase in sales of service contracts. While gross margin was positively impacted by an increase in sales of higher margin high throughput systems and economies of scale during 2016 compared to 2015, such positive impact was offset by the impact of a non-recurring charge for the repurchase of inventory in connection with the acquisition of the digital printing assets of SPSI during 2016 of $2.5 million and the fair value of the warrants issued to Amazon of $2.0 million, which negatively affected gross profit and resulted in a slight decrease in gross margin. Ink and consumables gross margin remained flat from 2015 to 2016.

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Operating Expenses

	Year Ended December 31,					
	2015		2016		Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	%
			($ in thousands)			
Operating expenses:						
Research and development	$11,950	13.8 %	$17,383	16.0	5,433	45.5%
Sales and marketing	13,367	15.5	18,338	16.9	4,971	37.2
General and administrative	9,500	11.0	12,259	11.3	2,759	29.0
Total operating expenses	$34,817	40.3 %	$47,980	44.2	13,163	37.7%

Research and Development. Research and development expenses increased by 45.5% in 2016 compared to 2015. This resulted primarily from an increase of $3.3 million in salaries and related personnel expenses and share based compensation due to the hiring of additional personnel in 2016 reflecting an increase in headcount compared to 2015, an increase of $1.3 million in costs due to increased research and development activity, which primarily includes $0.7 million in facilities costs in connection with the expansion of our headquarters in Rosh Ha'Ayin, Israel, and an increase of $0.6 million in depreciation due to the purchase of the digital direct to garment printing assets of SPSI in 2016. As a percentage of total revenues, our research and development expenses increased during this period, from 13.8% in 2015 to 16.0% in 2016.

Sales and Marketing. Sales and marketing expenses increased by 37.2% in 2016 compared to 2015. This increase was primarily due to an increase of $3.0 million in salaries and related personnel expenses and share based compensation expenses due to the hiring of sales and marketing personnel in 2016 reflecting an increase in headcount in 2016 compared to 2015, an increase of $0.7 million in marketing activities, including trade shows and online marketing activities, an increase of $0.6 million in costs of shipping to subsidiaries and an increase of $0.5 million in amortization of assets due to the purchase of the digital direct to garment printing assets of SPSI in 2016. As a percentage of total revenues, our sales and marketing expenses increased during this period from 15.5% in 2015 to 16.9% in 2016.

General and Administrative. General and administrative expenses increased by 29.0% in 2016 compared to 2015. This resulted primarily from an increase of $1.7 million in salaries and related personnel expenses and share based compensation due to the hiring of additional personnel reflecting an increase in headcount and compensation to executives compared to 2015, an increase of $0.4 million in expenses related to upgrades of our IT infrastructure, an increase of $0.3 million in legal expenses relating to settlement of a legal claim, an increase of $0.3 million in costs associated with being a publicly traded company and an increase of $0.2 million of facilities costs due to expansion of our facilities. These increases were offset by a decrease of $0.8 million due to a one-time payment in 2015 to Fortissimo Capital, our principal shareholder, in connection with the termination of our management services agreement with them and a decrease of $0.2 million due to one-time bonuses in 2015 in connection with our initial public offering. As a percentage of total revenues, our general and administrative expenses increased from 11.0% in 2015 to 11.2% in 2016.

Finance Income (Expenses), Net

Finance income (expenses), net reflected expenses of $0.3 million in 2015 and income of $0.05M in 2016. This change resulted primarily from interest accrued and received with respect to our cash investments and marketable securities in 2016 offset by the effects of exchange rates on our non-dollar denominated financial assets, specifically the exchange rate of the U.S. dollar to the NIS.

Taxes on Income

Taxes on income decreased slightly from $0.7 million in 2015 to $0.6 million in 2016.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP). These accounting principles are more fully described in note 2 to our consolidated financial statements included elsewhere in this annual report and require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. We believe that the accounting policies discussed below are critical to our financial results and to the understanding of our past and future performance, as these policies relate to the more significant areas involving management's estimates and assumptions. We consider an accounting estimate to be critical if: (1) it requires us to make assumptions because information was not available at the time or it included matters that were highly uncertain at the time we were making our estimate; and (2) changes in the estimate could have a material impact on our financial condition or results of operations.

We believe that the following significant accounting policies are the basis for the most significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

We generate revenues from the sale of our systems, ink and other consumables and value added services. We generate revenues from sale of our solutions directly to customers and indirectly through independent distributors. We recognize revenue when (1) persuasive evidence of a final agreement exists, (2) delivery has occurred or services have been rendered, (3) the selling price is fixed or determinable, and (4) collectability is reasonably assured. We recognize revenues from selling these products upon delivery, provided that all other revenue recognition criteria are met. In respect of sale of systems with installation and training, we consider the installation and training to be not essential to the functionality of the systems. Therefore, we recognized in accordance with the agreed-upon delivery terms once all other revenue recognition criteria have been met.

Revenues from service are derived mainly from the sale of print heads, spear parts and sale of service contracts. Print heads and spear parts revenues are recognized upon delivery, provided that all other revenue recognition criteria are met. The service contracts are recognized ratably, on a straight-line basis, over the period of the service.

We typically provide a one-year warranty on our systems. After the initial warranty period, we offer customers optional extended warranty contracts ranging generally from one to three years. Revenues from extended warranties are recognized ratably, on a straight-line basis, over the period of the service. Unearned revenues are derived mainly from these prepaid agreements. We classify the portion of unearned revenue not expected to be earned in the subsequent 12 months as long-term.

We periodically provide customer incentive programs including product discounts, volume-based rebates and warrants, which are accounted for as reductions to 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.

Revenues from ink and other consumable products are generally recognized upon shipment assuming all other revenue recognition criteria have been met.

In cases in which old systems are traded in as part of sales of new printers, the fair value of the old printer is recorded as inventory, provided that such value can be determined.

We assess collectability as part of the revenue recognition process. This assessment includes a number of factors such as an evaluation of the creditworthiness of the customer, past due amounts, past payment history, and current economic conditions. If it is determined that collectability cannot be reasonably assured, we defer recognition of revenue until collectability is assured.

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Inventories

Inventories are measured at the lower of cost or net realizable value. Cost is computed using weighted average cost, on a first-in, first-out basis. Inventory costs consist of material, direct labor and overhead. We periodically assess inventory for obsolescence and excess and reduce the carrying value by an amount equal to the difference between its cost and the estimated net realizable value based on assumptions about future demand and historical sales patterns. This valuation requires us to make judgments, based on currently available information, about the likely method of disposition, such as through sales and expected recoverable values of each disposition category. These assumptions about future disposition of inventory are inherently uncertain and changes in our estimates and assumptions may cause us to realize material write-downs in the future.

As of December 31, 2017, we had $34.9 million of inventory of which $15.8 million consisted of raw materials and components and $19.1 million consisted of completed systems, ink and other consumables. We recorded inventory write-offs in a total amount of $0.8 million, $2.2 million and $3.0 million for the years ended December 31, 2015, 2016 and 2017, respectively.

Share-Based Compensation

Under U.S. GAAP, we account for share-based compensation for employees in accordance with the provisions of the FASB’s ASC Topic 718 “Compensation—Stock Based Compensation,” or ASC 718, which requires us to measure the cost of options and RSU’s based on the fair value of the award on the grant date.

The fair value of each RSU is the market value as determined by the closing share price at the date of the grant.

We selected the binomial option pricing model as the most appropriate method for determining the estimated fair value of options which requires the use of subjective assumptions, including the expected term of the award and the expected volatility of the price of our common stock. We recognize compensation expense over the vesting period using the straight-line method and classify these amounts in the consolidated financial statements based on the department to which the related employee reports. We will continue to use judgment in evaluating the assumptions related to our share-based compensation expense on a prospective basis. As we continue to accumulate additional data, we may have refinements to our estimates, which could materially impact our future share-based compensation expense

Taxes

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. Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves when facts and circumstances change, such as the closing of a tax audit, the refinement of an estimate or changes in tax laws. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the effects of any reserves that are considered appropriate, as well as the related net interest and penalties.

We recognize deferred tax assets and liabilities for future tax consequences arising from differences between the carrying amounts of existing assets and liabilities under U.S. GAAP and their respective tax bases, and for net operating loss carryforwards and tax credit carryforwards. We regularly review our deferred tax assets for recoverability and establish a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. To make this judgment, we must make predictions of the amount and category of taxable income from various sources and weigh all available positive and negative evidence about these possible sources of taxable income.

While we believe the resulting tax balances as of December 31, 2015, 2016 and 2017 are appropriately accounted for, the ultimate outcome of such matters could result in favorable or unfavorable adjustments to our consolidated financial statements and such adjustments could be material. We have filed or are in the process of filing local and foreign tax returns that may be audited by the respective tax authorities. We believe that we adequately provided for any reasonably foreseeable outcomes related to tax audits and settlement; however, our future results may include favorable or unfavorable adjustments to our estimated tax liabilities in the period the assessments are made or resolved, audits are closed or when statute of limitations on potential assessments expire.

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Warranty costs

We typically grant a one-year warranty on our systems and record a provision for warranty at the time the product's revenue is recognized. We estimate the liability of possible warranty claims based on our historical experience. We estimate the costs that may be incurred under our warranty arrangements and record a liability in the amount of such costs at the time product revenue is recognized. We periodically assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

Marketable Securities

Marketable securities currently are comprised of debt securities. We determine the appropriate classification of marketable securities at the time of purchase and re-evaluate such designation at each balance sheet date. In accordance with FASB ASC No. 320, "Investment Debt and Equity Securities," we classify marketable securities as available-for-sale. Available-for-sale securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of shareholders' equity, net of taxes. Realized gains and losses on sales of marketable securities, as determined on a specific identification basis, are included in finance income, net. The amortized cost of marketable securities is adjusted for amortization of premium and accretion of discount to maturity, both of which, together with interest, are included in finance income, net.

We recognize an impairment charge when a decline in the fair value of our investments in debt securities below the cost basis of such securities is judged to be other-than-temporary. The determination of credit losses requires significant judgment and actual results may be materially different from our estimates. Factors considered in making such a determination include the duration and severity of the impairment, the reason for the decline in value, the ability of the issuer to meet payment obligations, the potential recovery period and our intent to sell, including whether it is more likely than not that we will be required to sell the investment before recovery of cost basis. For securities that are deemed other-than-temporarily impaired, the amount of impairment is recognized in the statement of operations and is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income (loss).

During the years ended December 31, 2016 and 2017, no other-than temporary impairment were recorded related to our marketable securities.

Recently Issued and Adopted Accounting Pronouncements

For a summary of recent accounting pronouncements applicable to our consolidated financial statements see Note 2, “Significant Accounting Policies” to the Consolidated Financial Statements included in Part III, Item 18 of this Annual Report on Form 20-F.

Taxation and Israeli Government Programs Applicable to Our Company

Israeli Tax Considerations and Government Programs

The following is a brief summary of the material Israeli tax laws applicable to us, and certain Israeli Government programs that benefit us.

General Corporate Tax Structure in Israel

Israeli companies are generally subject to corporate tax on their taxable income. As of 2018, the corporate tax rate is 23% (in 2017, the corporate tax rate was 24% and in 2016, the corporate tax rate was 25%). However, the effective tax rate payable by a company that derives income from a Preferred Enterprise or a Benefited Enterprise (as discussed below) may be considerably less. Capital gains derived by an Israeli company are subject to the prevailing corporate tax rate.

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Law for the Encouragement of Industry (Taxes), 5729-1969

The Law for the Encouragement of Industry (Taxes), 5729-1969, generally referred to as the Industry Encouragement Law, provides several tax benefits for "Industrial Companies." We currently qualify as an Industrial Company within the meaning of the Industry Encouragement Law.

The Industry Encouragement Law defines an "Industrial Company" as a company resident in Israel, which was incorporated in Israel and of which 90% or more of its income in any tax year, other than income from certain government loans, is derived from an "Industrial Enterprise" located in Israel and owned by it. An "Industrial Enterprise" is defined as an enterprise whose principal activity in a given tax year is industrial production.

The following tax benefits, among others, are available to Industrial Companies:

deduction of the cost of purchased know-how, patents and rights to use a patent and know-how which are used for the development or promotion of the Industrial Enterprise, over an eight-year period commencing on the year in which such rights were first exercised;

under limited conditions, an election to file consolidated tax returns with related Israeli Industrial Companies controlled by it; and

expenses related to a public offering are deductible in equal amounts over three years. , commencing in the year of the offering.

Eligibility for benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority.

There can be no assurance that we will continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

Law for the Encouragement of Capital Investments, 5719-1959

The Law for the Encouragement of Capital Investments, 5719-1959, generally referred to as the Investment Law, provides certain incentives for capital investments in production facilities (or other eligible assets) by “Industrial Enterprises” (as defined under the Investment Law).

The Investment Law has been amended several times over the recent years, with the three most significant changes effective as of April 1, 2005, or the 2005 Amendment, as of January 1, 2011, or the 2011 Amendment and as of January 1, 2017, or the 2017 Amendment. Pursuant to the 2005 Amendment, tax benefits granted in accordance with the provisions of the Investment Law prior to its revision by the 2005 Amendment remain in force but any benefits granted subsequently are subject to the provisions of the 2005 Amendment. Similarly, the 2011 Amendment introduced new benefits to replace those granted in accordance with the provisions of the Investment Law in effect prior to the 2011 Amendment. However, companies entitled to benefits under the Investment Law as in effect prior to January 1, 2011 were entitled to choose to continue to enjoy such benefits, provided that certain conditions are met, or elect instead, irrevocably, to forego such benefits and have the benefits of the 2011 Amendment apply. We have examined the possible effect of these provisions of the 2011 Amendment on our financial statements and have decided not to opt to apply the new benefits under the 2011 Amendment and the 2017 Amendment for our company, and for our Israeli subsidiary we elected to apply the benefit under the 2011 Amendment. The 2017 Amendment introduces new benefits for Technological Enterprises, alongside the existing tax benefits.

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Tax Benefits Subsequent to the 2005 Amendment

The 2005 Amendment applies to new investment programs and investment programs commencing after 2004, but does not apply to investment programs approved prior to April 1, 2005. The 2005 Amendment provides that terms and benefits included in any certificate of approval that was granted before the 2005 Amendment became effective (April 1, 2005) will remain subject to the provisions of the Investment Law as in effect on the date of such approval. Pursuant to the 2005 Amendment, the Israeli Authority for Investments and Development of the Industry and Economy, or the Investment Center, will continue to grant Approved Enterprise status to qualifying investments. The 2005 Amendment, however, limits the scope of enterprises that may be approved by the Investment Center by setting criteria for the approval of a facility as an Approved Enterprise.

The 2005 Amendment provides that Approved Enterprise status will only be necessary for receiving cash grants. As a result, it was no longer necessary for a company to obtain the advance approval of the Investment Center in order to receive the tax benefits previously available under the alternative benefits track. Instead, a company may claim the tax benefits offered by the Investment Law directly in its tax returns, provided that its facilities meet the criteria for tax benefits set forth in the 2005 Amendment. Companies or programs under the new provisions receiving these tax benefits are referred to as Benefited Enterprises. A company that has a Benefited Enterprise may, at its discretion, approach the Israel Tax Authority for a pre-ruling confirming that it is in compliance with the provisions of the Investment Law, as amended.

Tax benefits are available under the 2005 Amendment to production facilities (or other eligible facilities) which are generally required to derive more than 25% of their business income from export to specific markets with a population of at least 14 million in 2012 (such export criteria will further be increased in the future by 1.4% per annum). In order to receive the tax benefits, the 2005 Amendment states that a company must make an investment which meets certain conditions set forth in the amendment for tax benefits, including exceeding a minimum investment amount specified in the Investment Law. Such investment entitles a company to receive a “Benefited Enterprise” status with respect to the investment, and may be made over a period of no more than three years from the end of the year in which the company requested to have the tax benefits apply to its Benefited Enterprise. Where a company requests to have the tax benefits apply to an expansion of existing facilities, only the expansion will be considered to be a Benefited Enterprise and the company’s effective tax rate will be the weighted average of the applicable rates. In such case, the minimum investment required in order to qualify as a Benefited Enterprise must exceed a certain percentage of the value of the company’s production assets before the expansion.

The extent of the tax benefits available under the 2005 Amendment to qualifying income of a Benefited Enterprise depends on, among other things, the geographic location in Israel of the Benefited Enterprise. The location will also determine the period for which tax benefits are available. Such tax benefits include an exemption from corporate tax on undistributed income for a period of between two to ten years, depending on the geographic location of the Benefited Enterprise in Israel, and a reduced corporate tax rate of between 10% to 25% for the remainder of the benefits period, depending on the level of foreign investment in the company in each year. The benefits period is limited to 12 or 14 years from the year the company first chose to have the tax benefits apply, depending on the location of the company.

A company qualifying for tax benefits under the 2005 Amendment which pays a dividend out of income derived by its Benefited Enterprise during the tax exemption period will be subject to corporate tax in respect of the gross amount of the dividend distributed (grossed-up to reflect the pre-tax income that it would have had to earn in order to distribute the dividend) at the corporate tax rate which would have otherwise been applicable. Dividends paid out of income attributed to a Benefited Enterprise (or out of dividends received from a company whose income is attributed to a Benefited Enterprise) are generally subject to withholding tax at source at the rate of 15% or such lower rate as may be provided in an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). The reduced rate of 15% is limited to dividends and distributions out of income derived during the benefits period and actually paid at any time up to 12 years thereafter. After this period, the withholding tax is applied at a rate of up to 30%, or at a lower rate under an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). In the case of a Foreign Investors' Company (as such term is defined in the Investment Law), the 12-year limitation on reduced withholding tax on dividends does not apply.

The benefits available to a Benefited Enterprise are subject to the fulfillment of conditions stipulated in the Investment Law and its regulations. If a company does not meet these conditions, it would be required to refund the amount of tax benefits, as adjusted by the Israeli consumer price index, and interest, or other monetary penalties.

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We currently have Benefited Enterprise programs under the Investments Law, which, we believe, entitle us to a tax exemption for undistributed income and a reduced tax rate. The benefits period for our company began in 2010. Our company is expected to enjoy these tax benefits until 2019. Our subsidiary Kornit Technologies is subject to the 2011 Amendment (as described below) and thus the tax benefits will not be subject to time limitations.

Tax Benefits Under the 2011 Amendment

The 2011 Amendment canceled the availability of the benefits granted to companies in accordance with the provisions of the Investment Law prior to 2011 and, instead, introduced new benefits for income generated by a “Preferred Company” through its “Preferred Enterprise” (as such terms are defined in the Investment Law) as of January 1, 2011. The definition of a Preferred Company includes a company incorporated in Israel that is not wholly owned by a governmental entity, and that has, among other things, Preferred Enterprise status and is controlled and managed from Israel. Pursuant to the 2011 Amendment, a Preferred Company is entitled to a reduced corporate flat tax rate of 15% with respect to its preferred income derived by its Preferred Enterprise in 2011 and 2012, unless the Preferred Enterprise is located in a certain development zone, in which case the rate will be 10%. Such corporate tax rate reduced to 12.5% and 7%, respectively, in 2013 and increased to 16% and 9% in 2014 and through 2016. Pursuant to the 2017 Amendment, in 2017 and thereafter, the corporate tax rate for a Preferred Enterprise which is located in a specified development zone was decreased to 7.5%, while the reduced corporate tax rate for other development zones remains 16%. Income derived by a Preferred Company from a ’Special Preferred Enterprise’ (as such term is defined in the Investment Law) would be entitled, during a benefits period of 10 years, to further reduced tax rates of 8%, or to 5% if the Special Preferred Enterprise is located in a certain development zone. As of January 1, 2017, the definition of “Special Preferred Enterprise” includes less stringent conditions.

Dividends paid out of preferred income attributed to a Preferred Enterprise or to a Special Preferred Enterprise are generally subject to withholding tax at source at the rate of 20% or such lower rate as may be provided in an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). However, if such dividends are paid to an Israeli company, no tax is required to be withheld (although, if subsequently distributed to individuals or a non-Israeli company, withholding of 20% or such lower rate as may be provided in an applicable tax treaty will apply). In 2017 through 2019 dividends paid out of preferred income attributed to a Special Preferred Enterprise directly to a foreign parent company are subject to withholding tax at source at the rate of 5% (temporary provisions).

The 2011 Amendment also provided transitional provisions to address companies already enjoying existing tax benefits under the Investment Law. These transitional provisions provide, among other things, that unless an irrevocable request is made to apply the provisions of the Investment Law as amended in 2011 with respect to income to be derived as of January 1, 2011: (i) the terms and benefits included in any certificate of approval that was granted to an Approved Enterprise which chose to receive grants and certain tax benefits before the 2011 Amendment became effective will remain subject to the provisions of the Investment Law as in effect on the date of such approval, and subject to certain conditions; (ii) terms and benefits included in any certificate of approval that was granted to an

Approved Enterprise which had participated in an alternative benefits track before the 2011 Amendment became effective will remain subject to the provisions of the Investment Law as in effect on the date of such approval, provided that certain conditions are met; and (iii) a Benefited Enterprise can elect to continue to benefit from the benefits provided to it before the 2011 Amendment came into effect, provided that certain conditions are met. Kornit Technologies has filed a notification that it wishes to apply the new benefits under the 2011 Amendment.

New Tax benefits under the 2017 Amendment that became effective on January 1, 2017.

The 2017 Amendment was enacted as part of the Economic Efficiency Law that was published on December 29, 2016, and is effective as of January 1, 2017, The 2017 Amendment provides new tax benefits for two types of “Technology Enterprises”, as described below, and is in addition to the other existing tax beneficial programs under the Investment Law.

The 2017 Amendment provides that a technology company satisfying certain conditions will qualify as a “Preferred Technology Enterprise” and will thereby enjoy a reduced corporate tax rate of 12% on income that qualifies as “Preferred Technology Income”, as defined in the Investment Law. The tax rate is further reduced to 7.5% for a Preferred Technology Enterprise located in development zone A. These corporate tax rates shall apply only with respect to the portion of intellectual property developed in Israel. In addition, a Preferred Technology Company will enjoy a reduced corporate tax rate of 12% on capital gain derived from the sale of certain “Benefitted Intangible Assets” (as defined in the Investment Law) to a related foreign company if the Benefitted Intangible Assets were acquired from a foreign company on or after January 1, 2017 for at least NIS 200 million, and the sale receives prior approval from the Innovation Authority.

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The 2017 Amendment further provides that a technology company satisfying certain conditions will qualify as a "Special Preferred Technology Enterprise" and will thereby enjoy a reduced corporate tax rate of 6% on "Preferred Technology Income" regardless of the company's geographic location within Israel. In addition, a Special Preferred Technology Enterprise will enjoy a reduced corporate tax rate of 6% on capital gain derived from the sale of certain "Benefitted Intangible Assets" to a related foreign company if the Benefitted Intangible Assets were either developed by an Israeli company or acquired from a foreign company on or after January 1, 2017, and the sale received prior approval from the Innovation Authority. A Special Preferred Technology Enterprise that acquires Benefitted Intangible Assets from a foreign company for more than NIS 500 million will be eligible for these benefits for at least ten years, subject to certain approvals as specified in the Investment Law.

Dividends distributed by a Preferred Technology Enterprise or a Special Preferred Technology Enterprise, paid out of Preferred Technology Income, are generally subject to withholding tax at source at the rate of 20% or such lower rate as may be provided in an applicable tax treaty (subject to the receipt in advance of a valid certificate from the Israel Tax Authority allowing for a reduced tax rate). However, if such dividends are paid to an Israeli company, no tax is required to be withheld. If such dividends are distributed to a foreign parent company holding at least 90% of the shares of the distributing company and other conditions are met, the withholding tax rate will be 4%.

We qualify as a Preferred Technology Enterprise or Special Preferred Technology Enterprise, and we are considering whether to apply for benefits under the 2017 Amendment.

From time to time, the Israeli Government has discussed reducing the benefits available to companies under the Investment Law. The termination or substantial reduction of any of the benefits available under the Investment Law could materially increase our tax liabilities.

Foreign Tax Considerations

On December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act (the "Act"), which among other provisions, reduced the U.S. corporate tax rate from 35% to 21%, effective January 1, 2018.

We have made reasonable estimates of the effects on the existing deferred tax balances as of December 31, 2017, for which provisional amounts have been recorded. We re-measured certain of our U.S. deferred tax assets and liabilities, based on the rates at which we are expected to reverse in the future. The estimated tax expense recorded related to the re-measurement of the deferred tax balance was $355.

B. Liquidity and Capital Resources

As of December 31, 2017, we had approximately $18.6 million in cash and cash equivalents, $4.5 million in short term deposits and $74.4 million in marketable securities totaling $97.5 million. We fund our operations with cash generated from operating activities and cash raised during the IPO and the secondary offering. In the past, we have also raised capital through the sale of equity securities to investors in private placements.

Our cash requirements have principally been for working capital, capital expenditures and acquisitions. Our working capital requirements reflect the growth in our business. Historically, we have funded our working capital (primarily inventory and accounts receivables) and capital expenditures from cash flows provided by our operating activities, investments in our equity securities and cash and cash equivalents on hand. We have funded our acquisitions from the proceeds of our initial public offering and cash on hand. Our current capital expenditures relate primarily to investment in our new headquarters in the United States and in our manufacturing facility for our ink and other consumables in Kiryat Gat, Israel. In addition to investments in those facilities, our capital investments have included improvements and expansion of our worldwide locations and corporate facilities to support our growth and investment and improvements in our information technology.

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The most significant elements of our working capital requirements are for inventory, accounts receivable and trade payables. We partially fund the procurement of the components of our systems that are assembled by our third-party manufacturers. Our inventory strategy includes maintaining inventory of systems and inks and other consumables at levels that we expect to sell during the successive months based on anticipated customer demand. Our accounts receivable significantly decreased due to the improvement in our days sales' outstanding, or DSO. Our trade payables decreased due to the decrease in sales of systems.

As of December 31, 2017, the Company has two lines of credit with Israeli banks for total borrowings of up to $3 million, all of which was undrawn as of December 31, 2017. These lines of credit are unsecured and available subject to the Company's maintenance of a 30% ratio of total tangible shareholders' equity to total tangible assets and that the total credit use will be less than 70% of the Company and its subsidiaries' receivables. Interest rates across these credit lines varied from 0.2% to 2.3% as of December 31, 2017.

Based on our current business plans, we believe that our cash flows from operating activities and our existing cash resources will be sufficient to fund our projected cash requirements for at least the next 12 months without drawing on our lines of credit or using significant amounts of the net proceeds from our initial public offering or our follow-on offering. Our future capital requirements will depend on many factors, including our rate of revenue growth, the timing and extent of spending to support product development efforts, the expansion of our sales and marketing activities, and the timing of introductions of new solutions and the continuing market acceptance of our solutions as well as other business development efforts.

The following table presents the major components of net cash flows for the periods presented:

	Year Ended December 31,		
	2015	2016	2017
	(in thousands)		
Net cash provided by (used in) operating activities	$(2,210)	$956	$5,990
Net cash provided by (used in) investing activities	(58,871)	2,463	(46,744)
Net cash provided by financing activities	74,601	939	36,437

Net Cash Provided by (Used in) Operating Activities

Year Ended December 31, 2017

Net cash provided by operating activities in the year ended December 31, 2017 was $6.0 million.

Net cash provided by operating activities consisted of net loss of $2.0 million including 12 million from non-cash activities and a decrease of $9 million from accounts receivables due to lower revenues and higher payments received prior to the cutoff date. Our days sales' outstanding, or DSO, for the year ended December 31, 2017 was 74 compared to 106 for the year ended December 31, 2016.

During the period we had an increase of approximately $10.6 million in inventory from the year ended December 31, 2016 to the year ended December 31, 2017. This was primarily due to our strategy of increasing inventory levels to meet anticipated customer demand for our solutions. We also experienced a decrease of $3.6 million in trade payables due to a weaker fourth quarter 2017 compared to the fourth quarter of 2016.

Year Ended December 31, 2016

Net cash provided by operating activities in the year ended December 31, 2016 was $1.0 million.

Net cash provided by operating activities consisted of net income of $0.8 million and an increase of approximately $6.1 million in inventory from the year ended December 31, 2015 to the year ended December 31, 2016. This was primarily due to our strategy of increasing inventory levels to meet anticipated customer demand for our solutions.

During the same period, we experienced an increase of $2.8 million in trade payables due to growth of our business and more favorable payment terms from our suppliers. In addition, trade receivables increased by $9.3 million due primarily to the growth of our business and better payment terms to our customers. Our days sales' outstanding, or DSO, for the year ended December 31, 2016 was 106 compared to 95 for the year ended December 31, 2015 as a result of such better payment terms to our customers.

Net Cash Provided by (Used in) Investing Activities

Net cash used in investing activities was $46.7 million for the year ended December 31, 2017, which was primarily attributable to our investment in short term bank deposits and marketable securities. Net cash provided by investing activities was $2.5 million for the year ended December 31, 2016, which was primarily attributable to our proceeds from short-term bank deposits of $22.0 million offset by our purchase of marketable securities of $11.5 million, our investment in property and equipment of $5.5 million and $9.2 million paid in connection with our acquisition of SPSI.

Net Cash Provided by Financing Activities

Net cash provided by financing activities was $36.4 million for the year ended December 31, 2017, which was primarily attributable to our secondary offering in which we have raised $35.1 million. Net cash provided by financing activities was $0.9 million for the year ended December 31, 2016, which was attributable to the exercise of share options.

C. Research and development, patents and licenses, etc.

For a description of our research and development programs and the amounts that we have incurred over the last three years pursuant to those programs, please see "ITEM 4.B Business Overview—Research and Development."

D. Trend Information

Our results of operations and financial condition may be affected by various trends and factors discussed in "ITEM 3.D Risk Factors," including "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." and "ITEM 4.B Business Overview—Industry," changes in political, military or economic conditions in Israel and in the Middle East, general slowing of local or global economies and decreased economic activity in one or more of our target markets.

E. Off-Balance Sheet Arrangements

We do not currently engage in off-balance sheet financing arrangements. In addition, we do not have any interest in entities referred to as variable interest entities, which includes special purposes entities and other structured finance entities.

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F. Tabular Disclosure of Contractual Obligations

Our contractual obligations as of December 31, 2017 are summarized in the following table:

	Payments Due by Period (in thousands)						
	Total	2018	2019	2020	2021	2022	2023 and thereafter
Operating lease obligations (1)	$16,640	$2,504	$2,494	$2,465	$2,195	$2,088	4,894
Uncertain tax positions (2)	670						-
Purchase commitments (3)	16,475	16,475					-
Severance payment (4)	1,232						-
Total	$35,017	$18,819	$2,330	$2,296	$2,195	$2,088	4,894-

(1) Operating lease obligations consist of our contractual rental expenses under operating leases of facilities and vehicles.

(2) Consists of accruals for certain income tax positions under ASC 740 that are paid upon settlement, and for which we are unable to reasonably estimate the ultimate amount and timing of settlement. See Note 13(h) to our consolidated financial statements included in ITEM 18 of this annual report for further information regarding our liability under ASC 740. Payment of these obligations would result from settlements with tax authorities. Due to the difficulty in determining the timing of resolution of audits, these obligations are only presented in their total amount.

(3) Consists of all open PO commitments through the end of 2018.

(4) Severance payments of $1.23 million are payable only upon termination, retirement or death of our employees. Of this amount, $0.7 million is unfunded as of December 31, 2017. Since we are unable to reasonably estimate the timing of settlement, the timing of such payments is not specified in the table. See also Note 2(w) to our consolidated financial statements appearing included in “ITEM 18 Financial Statements” of this annual report.

ITEM 6. Directors, Senior Management and Employees.

A. Directors and Senior Management

The following table sets forth the name, age and position of each of our executive officers and directors as of the date of this annual report:

Name	**Age**	**Position**
Executive Officers		
Gabi Seligsohn	51	Chief Executive Officer and Director
Nuriel Amir	50	Chief Technology Officer
Guy Avidan	55	Chief Financial Officer
Gilad Yron	45	Executive Vice President of Global Business
Directors		
Yuval Cohen	55	