IAI

Israel Aerospace Industries Ltd.

2017 Sustainability Report
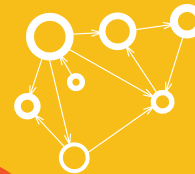
IAI

2017 in a nutshell

3.5 billion$ in Sales

62% of procurement is local

Backlog of orders at **11** of billion$

Record customer contracts at **5.8** billion$

Largest
high-tech company in Israel

14,857 employees

16,233 volunteering hours

6th ranking in the "best place to work" list

Sustaining over **50,000** households nationwide

54% hazardous waste recycled or reused

56% non-hazardous waste recycled or reused

500 GWh Saved since 2007

Message from our Board of Directors

IAI's 2017 sustainability report is a detailed record of our ongoing progress as a resilient, long-lasting, and extraordinary company. Our operations and products enable us not only to advance and achieve our business objectives, but also to fulfill our responsibilities towards our customers, employees, the communities in which we operate and society as a whole.

We make this commitment actionable through specific organizational mechanisms, starting with IAI's board of directors, which governs the setting and execution of our sustainability objectives to performance by IAI's management and employees.

Like many of our partners nowadays, we feel that caring for the planet, alongside its people, leads to a comprehensive and secure business growth. It is important that we, as industry leaders, be accountable for our operations, actions, products and facilities. We must conduct ourselves with integrity, transparency and determination to add value to our stakeholders, even in face of market instability and global risks, as witnessed in the past few years.

2017 yielded many technological and business achievements, as we expanded our global reach and our customer base. Side by side with our business opreations, we set five sustainability goals to be achieved by 2017. We managed to save on electricity, as well as improve our safety and health performance. We are determined to keep pursuing all of our goals, as well as raise the bar by committing to a detailed set of strategies and goals for 2023.

The very existence of IAI directly contributes to the strength and resilience of the local communities in which we operate across Israel. Our business model is built on identifying long term mega trends, and partnering with our customers to offer top quality technology excellence and innovations in every area they look to grow in. We report here in detail on the management of our environmental impact and the principles of pollution prevention and continual improvement integrated into our business. Further, IAI relies on the best people, our employees, cultivating each one's full potential and fostering a culture that rewards high performance and creativity. This report also explores our efforts to create a more diverse workforce, our community outreach, and ways for supporting our stakeholders' prosperity.

We care a great deal about building a more sustainable future. We believe that sharing our progress is highly beneficial and ethical, and provides our stakeholders with a full view of our successes and challenges. We invite you to extend your feedback and thoughts on our report, as it is, indeed, a never-ending evolution.

Harel Locker
Chairman of IAI's Board of Directors

Message from our President and CEO

For 65 years, IAI has expanded and thrived by making robust business decisions. Our progress relies on ensuring the company's long-term viability and success, while taking into account our social responsibility and environmental stewardship. IAI's third sustainability report complements our financial statements and allows our stakeholders to receive the broader picture of our commitments and their execution.

2017 had been a remarkable year, with a record rate of new projects and business partners joining hands with IAI, looking to achieve breakthrough innovations together. We value the trust and challenge we've been given by our current and prospective customers, and we are excited to help our partners meet their business objectives. Our success is the result of the effort, enthusiasm and professionalism of our employees, who go above and beyond to promote our business value through demonstrable innovative achievements and outstanding products in all arenas: air, sea, land, space and cyber. We work hard to bring forth the most advanced technological solutions, focusing on our customers' every need, while applying forward-looking practices and strong values of diversity, inclusion, social equity, ethics and integrity to every aspect of our work. We ensure our activities meet all current and upcoming regulatory changes, and embrace the highest standards for the management of our safety, health and environment aspects and impacts.

IAI had been cultivating social responsibility towards both our employees and within the communities we operate in since our founding days. Being one of the most influential companies in the Israeli market, IAI's business provides direct and indirect income to tens of thousands of families.

We are proud to be ranked 6th "best place to work" on the annual Israeli BDIcode INDEX, and "Platinum" in the MA'ALA ANNUAL INDEX at the Tel-Aviv Stock Exchange with leading performance on ethics, diversity, volunteerism, environmental management, and corporate governance.

Alongside our commitment to environmental excellence in our operations and facilities through our waste separation and recycling rates, advancing electricity savings and reducing air pollution, IAI keeps pursuing its environmental R&D, particularly around climate change impacts. From our participation in Horizon 2020 Clean Sky 2 project, to the innovative SKYTRAN green transportation system, from launching VENμS, the environmental monitoring satellite, to the implementation of 3D printing and advanced robotics in our manufacturing lines.

As we look into 2018 and beyond, we maintain our desire to keep instilling our triple-bottom line as a way-of-life in all our technological projects, operations and supply chain. Those elements will continue to evolve as part of IAI's long-term overall roadmap in a cross-organizational endeavor to be reported later on.

We received encouraging feedback from our stakeholders on previous reports, reassuring us that sharing our progress is indeed important, and that we are heading in the right direction. It is an exciting journey for our company; we hope you will find it too.

On a personal note, as I approach the end of my term as IAI's CEO, I would like to say how proud I am of the significant progress the company has made in the sustainability area over the past few years.

I believe sustainability is critical for the Company's future, and I have no doubt we will see the favorable outcomes of its implementation in the years to come.

Joseph Weiss
President and Chief Executive Officer

Independent Limited Assurance Report

102-56

Independent Limited assurance Report to the users/readers of Israel Aerospace Industries (IAI) Ltd. 2017 Sustainability Report.
We were engaged by the management of Israel Aerospace Industries Ltd. to provide limited assurance on the specified parts as mentioned in the table on page 7 (further referred to as "Specified parts"), regarding the information presented on IAI 2017 Sustainability Report for the year ended 31 December 2017 (further referred to as "The Report").

IAI management is responsible for A. the preparation and the presentation of the report in accordance with the Sustainability Reporting Standards (SRS): Core option, of the Global Reporting Initiative (GRI) as described in page 92 of the Report, and the information and assertions contained within it B. for determining IAI's objectives in respect of sustainable development performance and reporting, including the identification of stakeholders and material issues for reporting C. for establishing and maintaining appropriate performance management and internal control systems from which the information is derived, to be free from omissions and material misstatements whether due to fraud or error.

Our responsibility is to provide a limited assurance engagement and to express a conclusion based on the work performed. We conducted our engagement in accordance with International Standard on Assurance Engagements (ISAE) 3000, Assurance Engagements other than Audits or Reviews of Historical Financial Information, issued by the International Auditing and Assurance Standards Board. That standard requires that we comply with applicable ethical requirements, including independence requirements, and that we plan and perform the engagement to obtain limited assurance about whether the Report is free from material misstatement.

A limited assurance engagement, regarding data and information in the specified parts on the sustainability report, consists of making interviews and inquiries, primarily of persons responsible for the preparation of information presented in the report, and applying analytical and other evidence gathering procedures, as appropriate. These procedures included:

>> Examination of the specified parts in the report, for the purpose of performing a limited assurance, based on public information sources, knowledge of IAI business and other comparative information of similar organizations.

>> Inquiries of management to gain an understanding of IAI processes for determining the material issues for IAI key stakeholder groups.

>> Inquiries of management to gain an understanding regarding the specified parts.

>> Interviews with senior management and relevant staff at group level and selected business unit level concerning corporate responsibility strategy and policies for specified parts, and the implementation of these across the business.

>> Interviews with relevant staff at corporate and business unit level responsible for providing the information in the Report.

>> Visits to IAI's sites on the basis of a risk analysis including the consideration of both quantitative and qualitative criteria regarding the specified parts.

>> Visits and communication with the company sites located in Israel and the Company headquarters on the basis of a risk analysis including the consideration of both quantitative and qualitative criteria regarding the specified parts.

>> Comparing the information regarding the specified parts presented in the Report to corresponding information in the relevant underlying sources to determine whether all the relevant information contained in such underlying sources has been included in the report.

>> Where relevant, conducting interviews regarding the calculation, aggregation and methods used to collect and report the specified parts in the report.

>> Reading the information presented in the Report to determine whether it is in line with our overall knowledge of, and experience with, the corporate responsibility performance of IAI.

Limited assurance is less than absolute assurance and reasonable assurance. A limited assurance engagement is substantially less in scope than a reasonable assurance engagement in relation to both the risk assessment procedures, including an understanding of internal control, and the evidence-gathering procedures performed in response to the assessed risks, which vary in nature, and are substantially less in scope than for a reasonable assurance engagement. As a result, the level of assurance obtained in a limited assurance is substantially lower than the assurance that would have been obtained had we performed a reseaonable assurance engagement. We believe that the procedures we have performed and the evidence we have obtained is sufficient and appropriate to provide a basis for our conclusion.

Conclusion

Based on the limited assurance procedures performed and the evidence we have obtained, described in this report, nothing has come to our attention to indicate that the specified parts as mentioned in the table below in IAI's 2017 Sustainability Report are not presented, in all material respects, in accordance with the GRI (SRS) and IAI's reporting criteria.

Our limited assurance report is made solely to IAI in accordance with the terms of our engagement. Our work has been undertaken so that we might state to IAI those specified parts we have been engaged to state in this limited assurance report and for no other purpose or in any other context. We do not accept or assume responsibility to anyone other than IAI for our work, for this limited assurance report, or for the conclusions we have reached.

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Ziv Haft

Certified Public Accountants
Tel Aviv, Israel
August 15th, 2018

[1] Data regarding the percentage of direct employment of professional contractors employees was not covered by the assurance.

[2] Data regarding contractors' accidents was not covered by the assurance.

IAI in brief

Israel Aerospace Industries (IAI) is a world leader in the delivery of state-of-the-art sea, air, land, space, and cyber technologies and systems for defense, commercial and homeland security applications. Drawing on 65 years of experience in developing and supplying innovative solutions for customers around the globe, IAI tailors optimized products responding to the unique security and commercial challenges faced by each of our customers.

IAI is the largest government-owned defense and aerospace company in Israel. Over the years, IAI has delivered, supplied and supported advanced systems for the Israeli Ministry of Defense as well as for multiple customers worldwide.

As a national center of excellence in advanced technology fields, IAI maintains extensive research and development (R&D), engineering, manufacturing and testing capabilities for the development, production, certification and support of both complete systems and constituent elements – from components, sensors and subsystems to large scale fully-integrated system of systems.

IAI is the largest employer of engineers in Israel, over 6,000 in the year 2017, with R&D representing approximately a quarter of the company's annual budget.
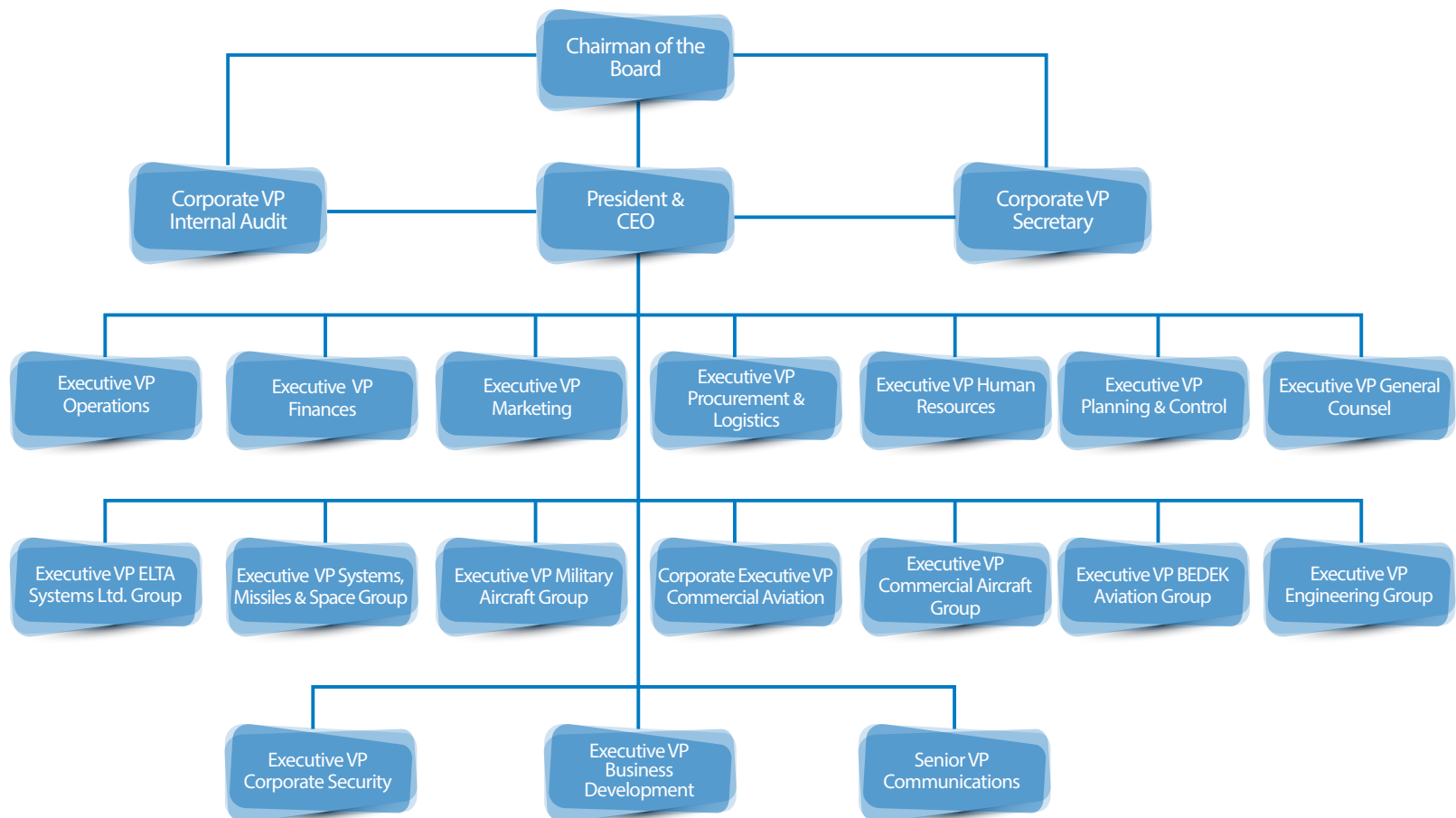
IAI Spotlight

30 years to the Lavi project

IAI's Lavi ("Young Lion" in Hebrew) jet fighter soared into the skies on its first flight on December 31st 1986, at 13:21, flown successfully and skillfully by IAI's Chief test pilot, Menahem Shmul. Nearly one year later, the project was cancelled following a formal decision made by the Israeli Government.

The development project of the single-engine fourth-generation multirole jet fighter was the pinnacle of earlier IAI successes in military aircraft – including the Fouga Magister trainer, the NESHER ("Eagle" in Hebrew) and the KFIR ("Lion Cub" in Hebrew) fighter. It was initiated in the late 1970's, with the lead of the Late Ovadia Harari as program manager, who later was the recipient of the Israel Prize in engineering and technology (1987) for this acheivement. The LAVI was to become the back bone jet fighter in the service of the Israeli air force. The design of the Lavi included state-of-the-art features, such as a digital flight control system (fly-by-wire), progressive display in the cockpit (HOTAS), an avionics system which included a radar and an intensive and complex level of software and hardware components. Most of the Lavi's structure was based on composite materials, which, combined with the PW1120 engine, allowed for a small, aerodynamic, highly maneuverable jet, excelling on the payload and long-distances aspects. The wing design had a delta configuration combined with close coupled canards for additional lift and agility. During the developments flight tests performed by the project shutdown, the LAVI had demonstrated superb capabilities – exclusive maneuverability, superb controlability, and outstanding realiability, compared to Israel's Airforce topline fighters, the F-15 and F-16.

The legacy of the LAVI laid the foundation for many of IAI's current technologies. The LAVI TD (Technologies Demonstrator), which took off on September 25th 1989, allowed for the continual testing and enhancement of many of the original LAVI systems, and lasted 162 flights.

Following the project's termination, IAI parted with over 3,000 employees, and the focus of the company turned to aircraft upgrades and modernization, developing business jets, UAVs and mission aircraft and evolving electronics and phased array radar systems. At the same time, a new frontier captured IAI's attention – reaching space.

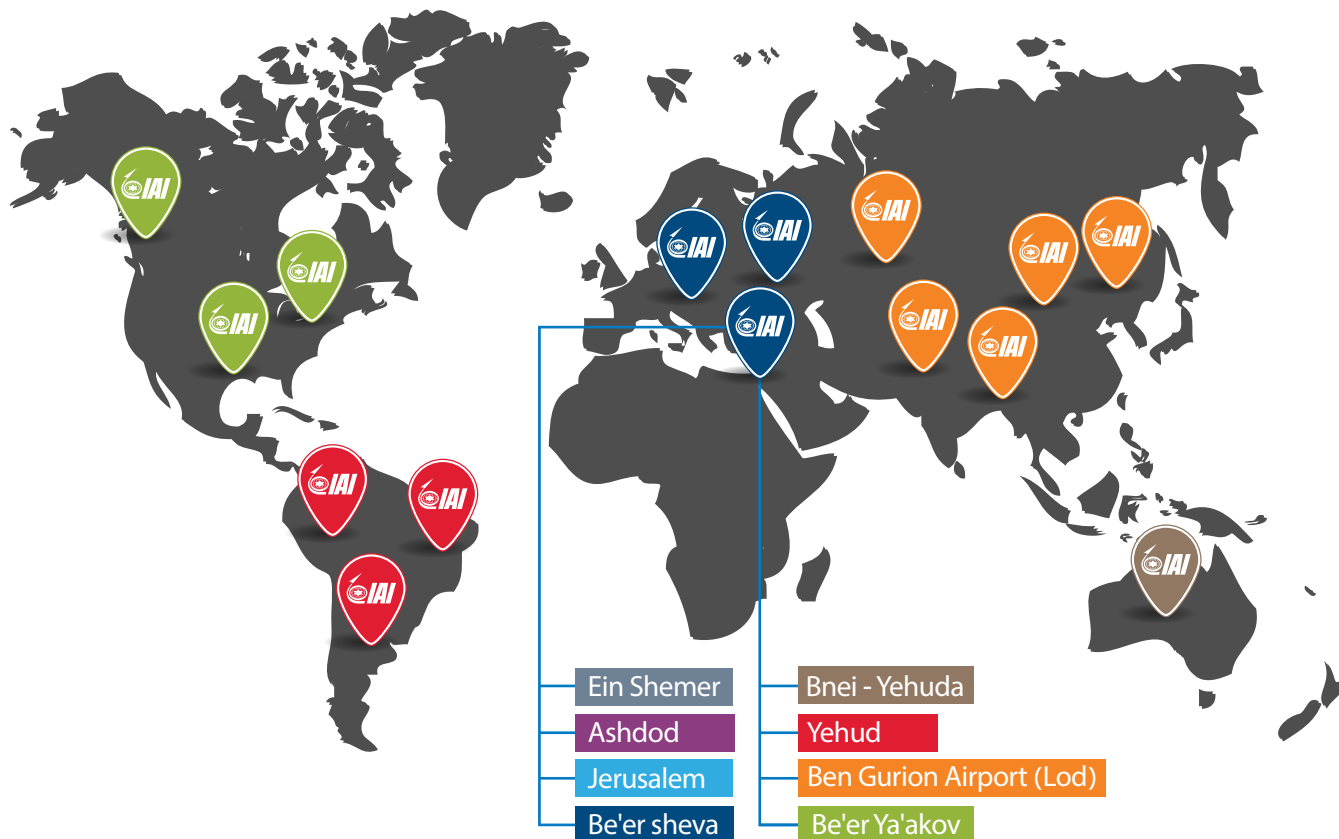# Creating a difference - locally and globally

102-3 | 102-4 | 102-5 | 102-6 | 102-7 | 102-45

IAI was established in 1953 in Lod, Israel, as BEDEK Aviation Ltd. We became Israel Aircraft Industries Ltd. in 1966 and Israel Aerospace Industries Ltd. in 2007. IAI's headquarters is situated at Ben-Gurion Airport, Lod. IAI has eight operational sites in Israel, employing 14,857 workers. We sustain over 50,000 households nationwide, taking into consideration all circles of employment.

IAI is a "wholly owned Governmental Company", as defined in the Israeli Governmental Companies Law - 1975. The Company's debentures were issued and listed for trade on the Tel-Aviv Stock Exchange effective May 2007 whereas the Company's shares are not listed for trade. The company's Board of Directors oversees the execution of its policy by the Senior Management - IAI President and Chief Executive Officer and Vice presidents.

ELTA systems Ltd., included in this report as an IAI group, has a dual status, as it operates both a group and as a subsidiary.

The majority of the company sales are in the military and defense markets, representing 70% in 2017. Most of the company's product sales are abroad, about 76% in 2017.

Ein Shemer	Bnei - Yehuda
Ashdod	Yehud
Jerusalem	Ben Gurion Airport (Lod)
Be'er sheva	Be'er Ya'akov

Products and Services
102-2 | 102-6

Missile Defense

IAI has led the development of Israel's multi-layered missile defense program since 1990, as the prime contractor for the ARROW 2 and 3 missile defense systems and provider of key sensors for other widely deployed air and missile defense systems. IAI is also leading the groundbreaking BARAK 8 program, an advanced surface-to-air missile (SAM) providing ultimate protection against a variety of aerial platforms, in both land and naval scenarios.

Unmanned Systems

IAI is a global leader in the design, development, and manufacturing of unmanned systems, supporting a wide range of advanced unmanned aerial vehicles (UAV), unmanned ground vehicles (UGV) and unmanned surface vessels (USV). As a pioneer with over 40 years of experience, over 50 customers worldwide and 1,500,000 operational flight hours, IAI's systems perform intelligence gathering and targeting missions in support of key military operations.

Naval Systems

IAI offers comprehensive naval solutions ranging from integrated systems - including maritime radars, EO payloads, sensors and command and control for vessels, helicopters, and aircraft - to security systems and unmanned vessels for coastal and offshore platform security applications. The naval solutions also include Naval Self Protection Systems such as Missile Approach Warning Systems and response systems (i.e. Smoke, Chaff and/or Flare), all of which are designed to increase the survivability of naval platforms vis-à-vis various threats, including coastal weapons. IAI's defense systems include the Barak family of anti-air and anti-missile defense system and the GAVRIEL anti-ship attack missile.

In addition, IAI offers the SUPER DVORA Class of Multi-Mission Patrol & Attack Boats - the ideal purpose designed high Speed-high endurance platform for a diverse variety of military and non-military missions.

Intelligence Surveillance, Reconnaissance (ISR)

IAI delivers real-time reconnaissance, electronic intelligence capabilities through turnkey solutions focusing on strategic and targeting assets. These include Signal Intelligence (SIGINT), Image Intelligence (IMINT), Synthetic Aperture Radar (SAR) technologies, and day & night EO/IR systems, all implemented through integrated, networked and connected system of systems.

Aircraft and Helicopters Modernization and Upgrade

IAI has been implementing modernization and upgrade programs for military aircraft and helicopters for over four decades. Based on its extensive track record as an aircraft manufacturer, IAI has successfully transformed previous generation platforms on aircraft and helicopters of Eastern and Western origin into advanced, effective systems capable of meeting current and future most demanding mission requirements. Modernization packages often include a comprehensive life extension and system upgrades with advanced avionics, training equipment, simulators, and mission planning and debriefing systems. IAI also offers Airborne Self Protection Systems, such as Missile Approach Warning Systems and response systems. These systems are installed on military aircraft and helicopters, as well as on VIP and Commercial aircraft.

Products and Services

Homeland Security (HLS)

Operational in some of the world's most sensitive conflict areas, IAI's C4I systems, sensors, radars, and electro-optical payloads are securing a wide range of protected sites; from borders and coastlines, national symbols and strategic infrastructures, to population centers. IAI's comprehensive, integrated solutions utilize airborne, ground-based, maritime, or mobile sensors, augmented by unattended platforms like aerostat or unmanned patrol vehicles, through secure information networks.

Ground Systems

IAI develops advanced systems and capabilities for use by land forces, including state-of-the-art battle management and communication systems supporting on-the-move broadband communications and integrated targeting and navigation technology for precision guided weapons. IAI also offers a wide range of combat support systems – from guided missiles to obstacle breaching, countermine, and counter-IED. Additionally, IAI delivers combat-proven radar-based early warning systems for Armored Vehicle Protection, mounted on tanks, APCs, and other combat vehicles, allowing a timely activation of adequate interceptors.

Electronic Warfare (EW) Systems

IAI develops and supplies advanced Electronic Counter Measures systems; jamming pods for combat aircraft and Communication Jammers.

Mission Aircraft

IAI's combat-proven solutions include Airborne Early Warning System (AEW), Airborne Integrated SIGINT system (AISIS), Multi-Mission Airborne Reconnaissance and Surveillance System (MARS2), and Maritime Patrol Aircraft (MPA). Each mission aircraft is tailored to the user's needs, from the mission super system to the airborne platform (jet or turboprops-based).

Aerospace Engineering and Development Center

IAI maintains an excellence center for aerospace engineering and development. As a member of the exclusive club of civil aircraft OEM's (FAR 25 & FAR 23 categories), IAI is fully capable to design, develop and certify new air-vehicles and provide engineering, upgrade and conversion services for aircraft of any type: from initial concept definition to prototype testing and certification, from fast prototype to full scale development of manned and unmanned, commercial and military aerial platforms. With unique synergy of industry experts, highly-skilled engineers and experienced Israeli test-pilots, combined with a legacy of comprehensive disciplines, cutting edge technologies and innovative laboratories and test centers, IAI's Engineering and Development Center is designed to build the aircraft of tomorrow - turning a vision into a flying machine.

Products and Services

Commercial Aviation

IAI designs and manufactures business jets for nearly 45 years, from the early Westwind, the Astra, and the Galaxy, through the G100, G150, and the G200 for Gulfstream, to the super midsize intercontinental range G280. The G100, G150, G200, and the G280 business-jests are an integral part of the Gulfstream family of business-jets. Furthermore, IAI designs, develops and manufactures primary composite and non-composite aero structure assemblies for major aerospace OEMs, as well as landing gear, servo control and actuator systems.

Aircraft Conversions and MRO

IAI is a known global leader in aircraft passenger-to-cargo conversions, with over 40 years of experience and more than 200 converted aircraft delivered to date. IAI develops its own STC (BDSF) for a range of aircraft cargo conversions, for both commercial and military markets. All STCs are approved and validated by leading Aviation Authorities. Moreover, IAI developed a Boeing 767 conversion for Multi-mission tanker/transport aircraft and air-refueling platforms.

IAI also provides an expert, one-stop-shop for large passenger and cargo aircraft, with full maintenance, repair, and overhaul (MRO) of aircraft, engines, and components. IAI's MRO processes are approved by 18 Aviation Authorities from around the world.

Space

Positioned as Israel's leading Integrator of space technology, IAI has a proud legacy of dozens of satellites deployed in space. IAI develops and manufactures a wide range of cutting edge satellites and satellite equipment, including observation and communication satellites, scientific/research satellite systems, ground control stations, mission centers, and launchers.

With the latest members of OPTSAT-3000, an electrical-optical imaging satellite product line, TECSAR (Synthetic Aperture Radar), an observation satellite line, and the AMOS communications satellite product line, IAI provides top performance and cost effective solutions for both national security and commercial applications.

Cyber

IAI offers a comprehensive suite of cyber-intelligence, cyber early warning, and cyber training and simulation systems for defense, intelligence, and law enforcement and homeland security applications. IAI's capabilities address all operational levels, from signal interception and analysis, to advanced, user-directed monitoring, assessment, and targeting. IAI's Cyber solutions also include National Cyber Centers and comprehensive solutions for airports cyber security.

Robotics

IAI's robotics center is at the cutting edge of the robotics technology in autonomous navigation, C4I, sensor fusion, communications, high and low level control, and micro robotics. IAI's robotics development methodology is integrated with operational experience, creating practical robotic solutions for a wide range of operational fields and missions. IAI's robotics building blocks include: platforms, navigation technology, world sensors, and world modeling technology, communication systems, and command & control (training simulations).

Our sustainability program

102-26 | 102-32

IAI sustainability management is cross organizational, including all groups, divisions, operations, and subsidiaries. The program starts at the top, with a Board of Directors' Sustainability Committee, overseeing a Senior Management Sustainability Steering Committee, led by the Executive VP of Operations, supervising, in turn, IAI's Sustainability and Environmental Organization. The Board Committee is responsible, among other things, for the approval of IAI's periodic sustainability reports. Through these authorities, we form manageable, measurable, and consistent working plans, strategically directing the company's progress in sustainability matters.

Our sustainability management is directly derived from our sustainability policy (available on our sustainability website), which dictates both the focus of the Senior Management Sustainability Steering Committee and the strategic work of the Sustainability and Environment Organization, as well as the Targets and Objectives assigned to the functional units (i.e. The divisions, HR, P&L, Finance etc.) in sustainability issues.

IAI's Sustainability Policy *

Senior Management Sustainability Steering Committee

Sustainability and Environment Organization

Setting strategy and defining tartgets and objectives

Performance versus plans

Divisions and Functional units
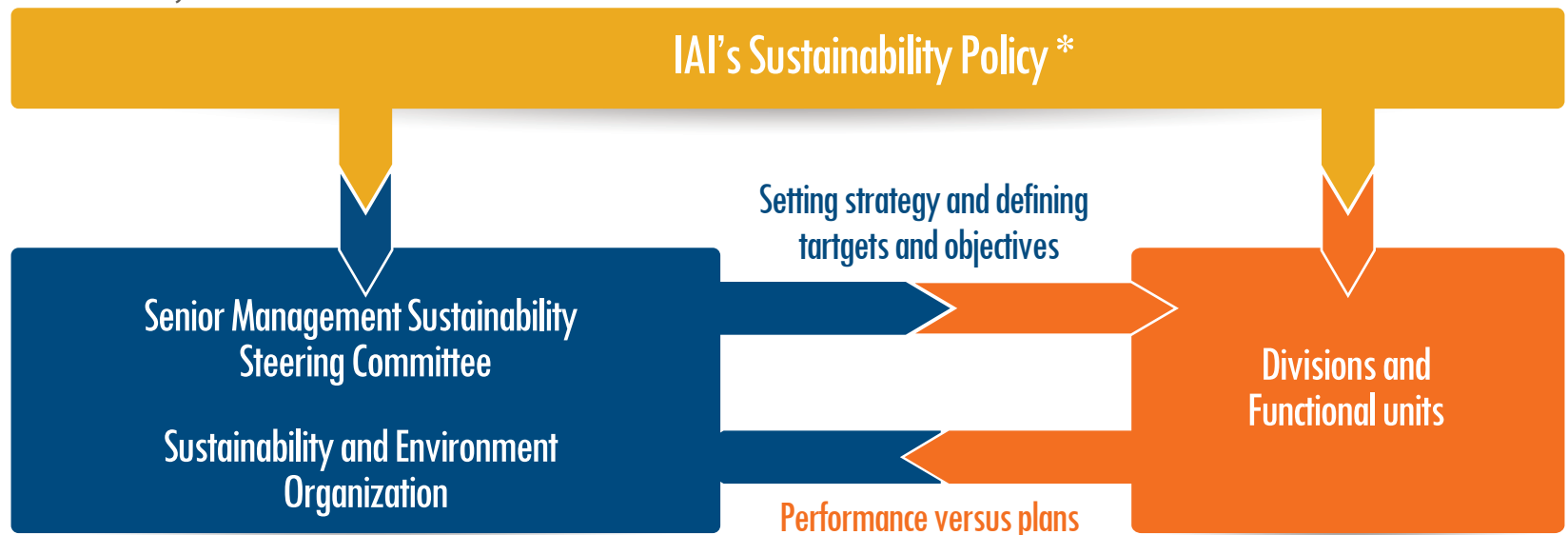
>> Creating cross company sustainability infrastructures and management tools, Implementation strategies and a central sustainability knowledge base

>> Publishing IAI's sustainability reports

>> Developing sustainability data systems

>> Leveraging sustainability excellence opportunities

>> Managing sustainability risks

>> Allocating an annual budget

>> Creating annual work plans for sustainability issues

>> Routine report-out to the sustainability and Environment Organization

* Based on the company's 21 material issues as identified in an in-depth management process

IAI Spotlight

Joining MA'ALA index

102-13

On June 2017, IAI had participated for the first time in MA'ALA ANNUAL INDEX, benchmarking Israeli companies on social responsibility performance. The voluntary index requires the disclosure of detailed information regarding the companies' impact on society and the environment: Ethics and Transparency, Work Environment and Employment, Human Rights, Diversity and Inclusion, Responsible Supply Chain, Volunteerism, Environmental Management and Corporate Governance. Companies ranked in the Index are included in MA'ALA CSR INDEX at the Tel-Aviv Stock Exchange.

IAI ranked "Platinum", with leading performance on ethics, diversity, environmental management and corporate governance.

Our Stakeholders

102-40 | 102-42 | 102-43 | 102-44 | Limited Assurance

We firmly believe that our business cannot operate and grow effectively without strong and nurturing ties to all of those who hold an interest in us. Healthy relationships with both internal and external stakeholders serve as a fantastic opportunity to learn, share, and improve wherever applicable and feasible.

Our major stakeholders are: the Israeli Government, customers, employees, suppliers and contractors, communities and future Generations.

Employees

Our personnel are the heart of the company. Our employees, at all levels of authority, are the true value-makers of IAI. We hold the belief that their invaluable day-to-day contribution shapes and grows this company. We strive to develop and support our employees in their roles and responsibilities while reaching to their families and providing comprehensive retirement plans. Our employees' organization forms a collective voice and represents the interests of our employees in all aspects concerning work environment and wellbeing.

The Israeli Government

As our owners, we walk hand in hand, facing the challenges posed to our country each day. We endeavor to work responsibly and formulate business strategies and principles in order to continue to grow and prosper, while maintaining the full trust placed by the government in our ability to create a sustainable and remarkable operation. In addition, we strive to establish strong ties with local authorities in order to keep in compliance with all their requirements.

Customers

We go to great length to ensure that our customers receive outstanding support and services provided by our products, services, and solutions. We are continuously attentive to our customers' feedback, in order to improve and exceed their expectations.

Communities

In our desire to prosper for the years to come, we find that engaging with local communities in the vicinity of our operational sites while focusing on their concerns, issues, and needs are mutually beneficial, creating a shared value and making a real difference.

Suppliers and Contractors

Through our supplier selection and management processes, we engage a multitude of contractors and suppliers – from development and manufacturing, to security, catering, transportation, etc. The invaluable cooperation in our value chain is promoting mutual growth and adoption of progressive standards.

Future Generations

As our founders envisioned, we care about leaving a legacy of which our children, their children, and grandchildren can be proud of and continue to share. While future generations cannot voice their minds, we do acknowledge their entitlement to a healthy and resource-abundant planet and thriving work prospects. As a result, we strive to consider and take responsibility for the long-term impacts of our current business.

102-40 | Limited Assurance

Stakholders' Dialogue Process

102-40 | 102-42 | 102-43 | 102-44 | Limited Assurance

In 2016, we began laying the foundations for the creation of short and long-term stakeholders' dialogue processes, relying on acceptable international standards. We keep on track with the following timeline:

▶ To be completed   ▶ In progress   ▶ completed

05 Materiality process with stakeholders dialogue

04 Engaging stakeholders

03 Setting stakeholders dialogue plans and timelines

02 Establishment of stakeholders dialogue strategy and methodology

01 IAI's stakeholders analysis (Major and Minor)

| 2016 | 2017 | 2018 | 2019 |

In 2016, we have identified our main stakeholders in an inclusive process covering the management and the employees' organization, the media, private and public information requests, regulatory demands, internal policies, etc. In 2017, we have mapped existing stakeholder engagement platforms, and processes **around sustainability issues**, to be further expanded in 2018-2019.
Some of these engagement platforms and processes are described here:

The government of Israel (owners) and regulatory authorities:

IAI is an active partner at the social responsibility forum for Israeli governmental companies, initiated by the Government Companies Authority. IAI also holds on-going meetings around specific sustainability issues with different authorities, such as the Ministry for Environmental Protection and the Commision for Equal Opportunities at the Workplace, under the Minsitry of Labor, Social Affairs and Social Services.

Employees, employees' families and our retirees:

IAI is utilizing a range of communication tools for the engagement of our employees, including: Employee satisfaction and feedback surveys, weekly and ad hoc internal communication, INTRANET website, joint work councils of management and employees' organization, IAI retirees' engagement program, sustainability e-learning module, job fairs, sustainability lectures as part of management-, projects-, and engineering-personnel training.

Customers:

IAI is operating a customer service, deploying annual customer satisfaction surveys, engages customers during our annual Take-off day, and works in joint collaborations through the International Aerospace Environment Group (IAEG).

Suppliers and contractors:

IAI connects with its suppliers through a designated suppliers' web portal, participates in industry-specific joint committees and memberships with our suppliers' representatives, and works in joint collaborations through the International Aerospace Environment Group (IAEG).

Communities:

IAI promotes an employee volunteering program, continously assesses needs with local communities adjacent to our operations, as well as various NGOs throughout the country, connects through social media and press, arranges tours and visits in our sites, and collaborates with the academia and a range of research centers in Israel and abroad (including the EU Horizon 2020 initiative).

Future generations:

IAI leads an annual project, "The women engineers of tomorrow", allowing our female engineers to mentor high-school girls, operating ORT high school within our premises, and supports various technological education initiatives in local schools.
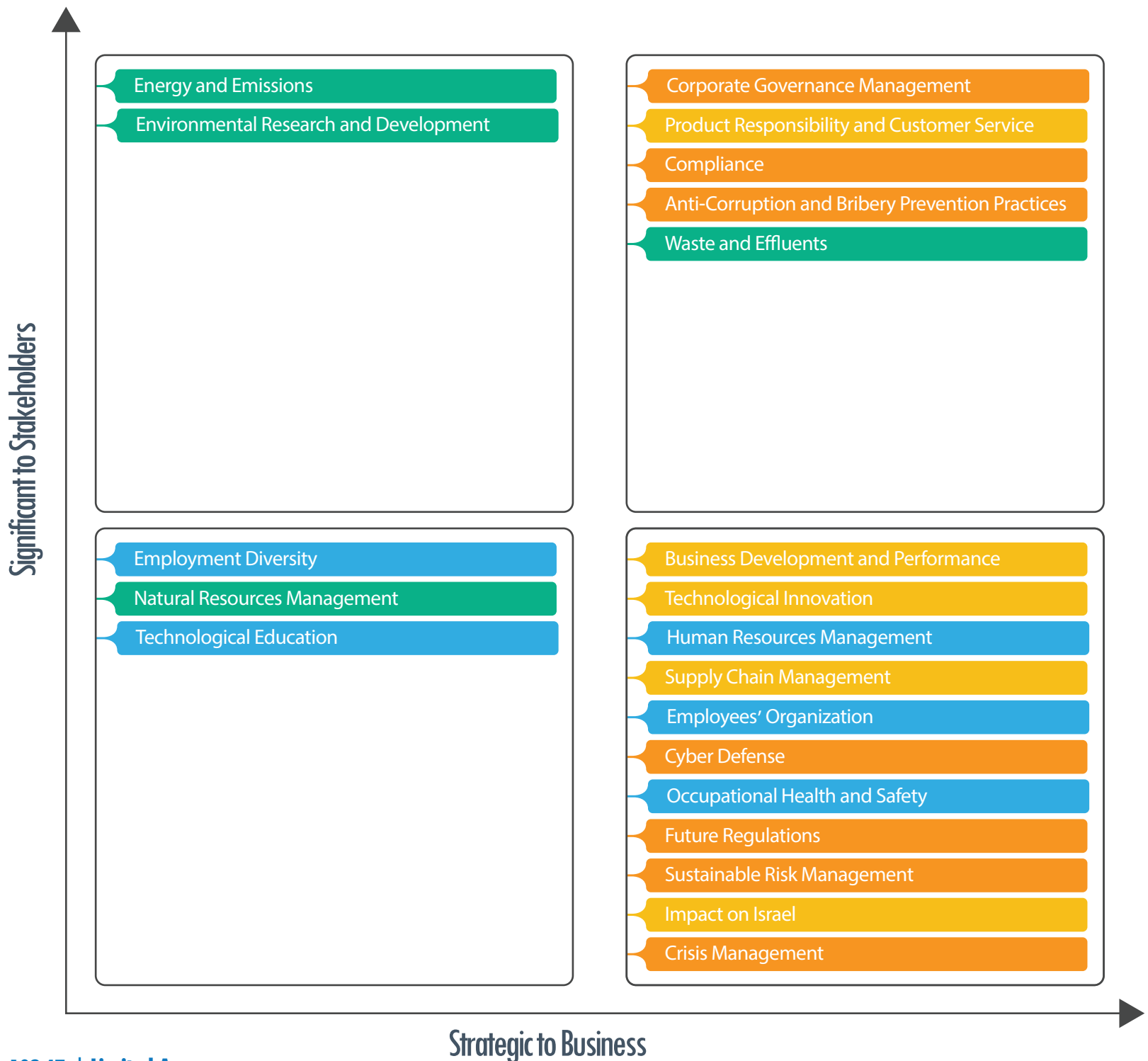
Materiality

In 2015-2016 IAI had committed to a systematic assessment of its material issues. Our aim was to identify the key corporate responsibility issues, which we as a business, consider material to the environment, the society, and the economy, based on internal roundtables. We also included insights from work undertaken as part of cross-organizational sustainability practices and processes. We have also taken into account those issues that our stakeholders, such as governmental authorities, sector colleagues, and the public in general, consider to be most relevant. The outcome enabled us to define the report contents in alignment with the GRI standards reporting principles of completeness, our approach to sustainability and our stakeholders.

We anticipate reviewing and re-validating our material issues in 2019, to ensure we keep moving in the most relevant direction, aligning our business with feedback from stakeholders.

The process was thoroughly described in our 2015 sustainability report, and briefly described here:

Process milestone	Milestone output
01 Defining materiality process: scope and goals	**01** › Process goals › Process roadmap › list of contributing parties and resources › Chosen validation methodology for results
02 Identifying potential material topics	**02** › Creation of a comprehensive list of potential material topics (Major and minor) based on multiple internal and external sources
03 Categorizing the material topics	**03** › Clustered list of potential material topics as a basis for the weighing process
04 Validating the material topics	**04** › The material topics categorization was validated by internal roundtable reviews
05 Ranking the material topics	**05** › Training of all ranking participants › Ranked list of IAI's material topics
06 Management review	**06** › Final materiality matrix › Statistical validation of the results
07 Stakeholder feedback	**07** › In progress (see pages 18-19)

Significant to Stakeholders (y-axis)

Strategic to Business (x-axis)

Top-left quadrant:
- Energy and Emissions
- Environmental Research and Development

Top-right quadrant:
- Corporate Governance Management
- Product Responsibility and Customer Service
- Compliance
- Anti-Corruption and Bribery Prevention Practices
- Waste and Effluents

Bottom-left quadrant:
- Employment Diversity
- Natural Resources Management
- Technological Education

Bottom-right quadrant:
- Business Development and Performance
- Technological Innovation
- Human Resources Management
- Supply Chain Management
- Employees' Organization
- Cyber Defense
- Occupational Health and Safety
- Future Regulations
- Sustainable Risk Management
- Impact on Israel
- Crisis Management

102-47 | Limited Assurance

Legend:
- Environmental
- Social
- Corporate Governance
- Economic

2017-2018 Sustainability Goals

Limited Assurance

Based on our 2015-2016 performance, the following strategic five objectives were defined for 2017, to be directly tracked by the Sustainability Board committee and the Senior Management Steering Committee for sustainability. These goals are a part of a larger set of sustainability goals formulated in order to support continual progress in our overall company sustainability.

As the company engages in setting its 2019-2023 sustainability goals (see page 23), it was decided to maintain the same five strategic objectives for 2018.

2017 performance vs. goals

Achieve a 2% cross-organizational electricity savings.

In 2017, we have successfully saved 2.6% of our electricity consumption.

Met!

Initiate gradual implementation of IAEG's harmonized supplier questionnaire (Module 1).

An initial suppliers assessment was performed, we expect to gain more progress in the consecutive year.

In progress

Achieve a 35% overall women intake from our total new employees hiring.

28.3% of our 2017 intake were women.

In progress

Increase percentages of diverse work populations (Orthodox Jews, Druze, Ethiopian-origin and employees with disabilities) based on specific intake goals.

We have improved on all our diversity intake rates, aside from employees with disabilites. we expect to gain more progress in the consecutive year.

In progress

Improving safety and health performance, including that of contractors in our operation sites.

We showed overall improvement in our safety and health performance indicators, further work is in progress regarding our contractors.
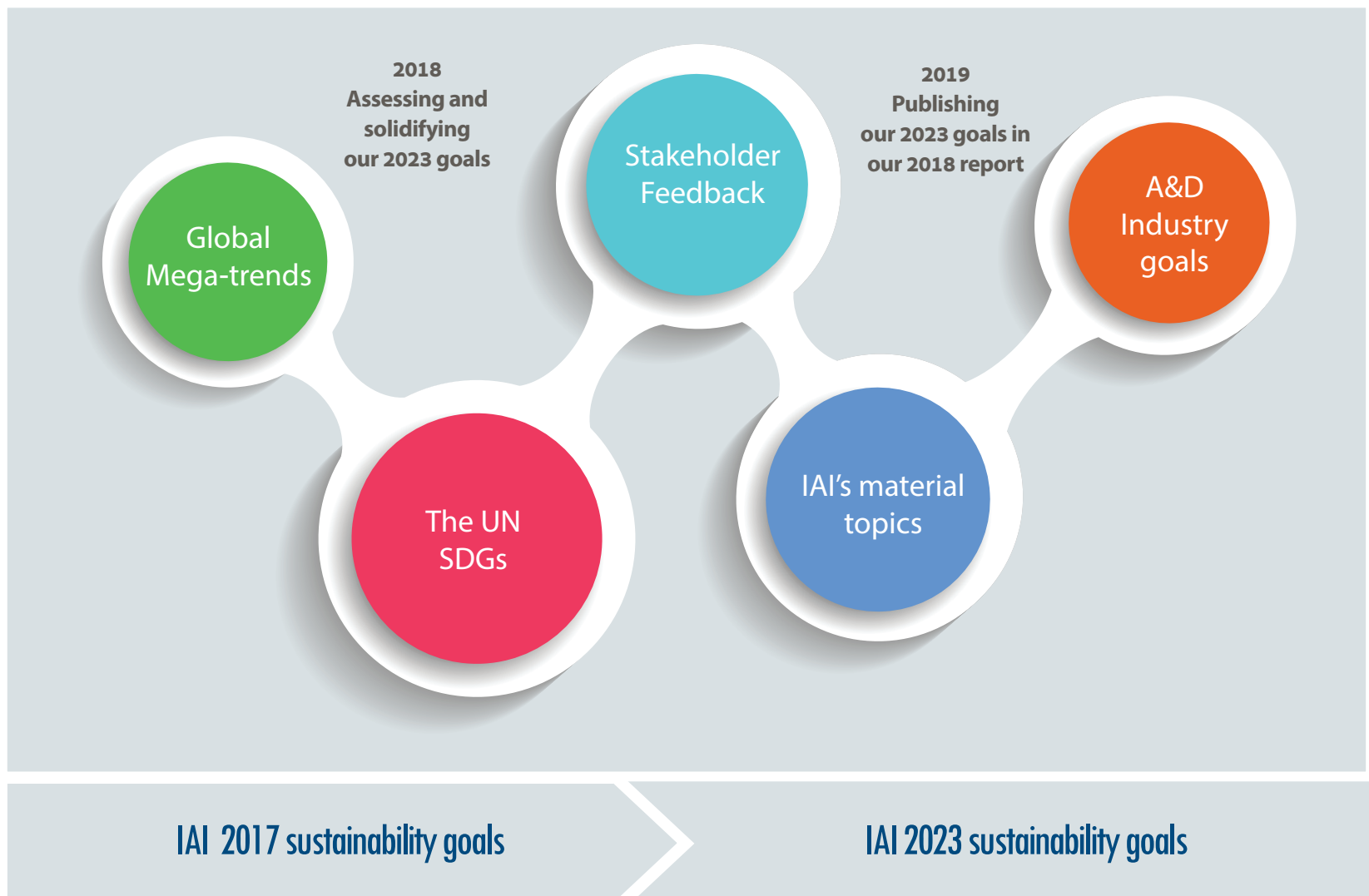
Met!

2018 goals Same as 2017 goals

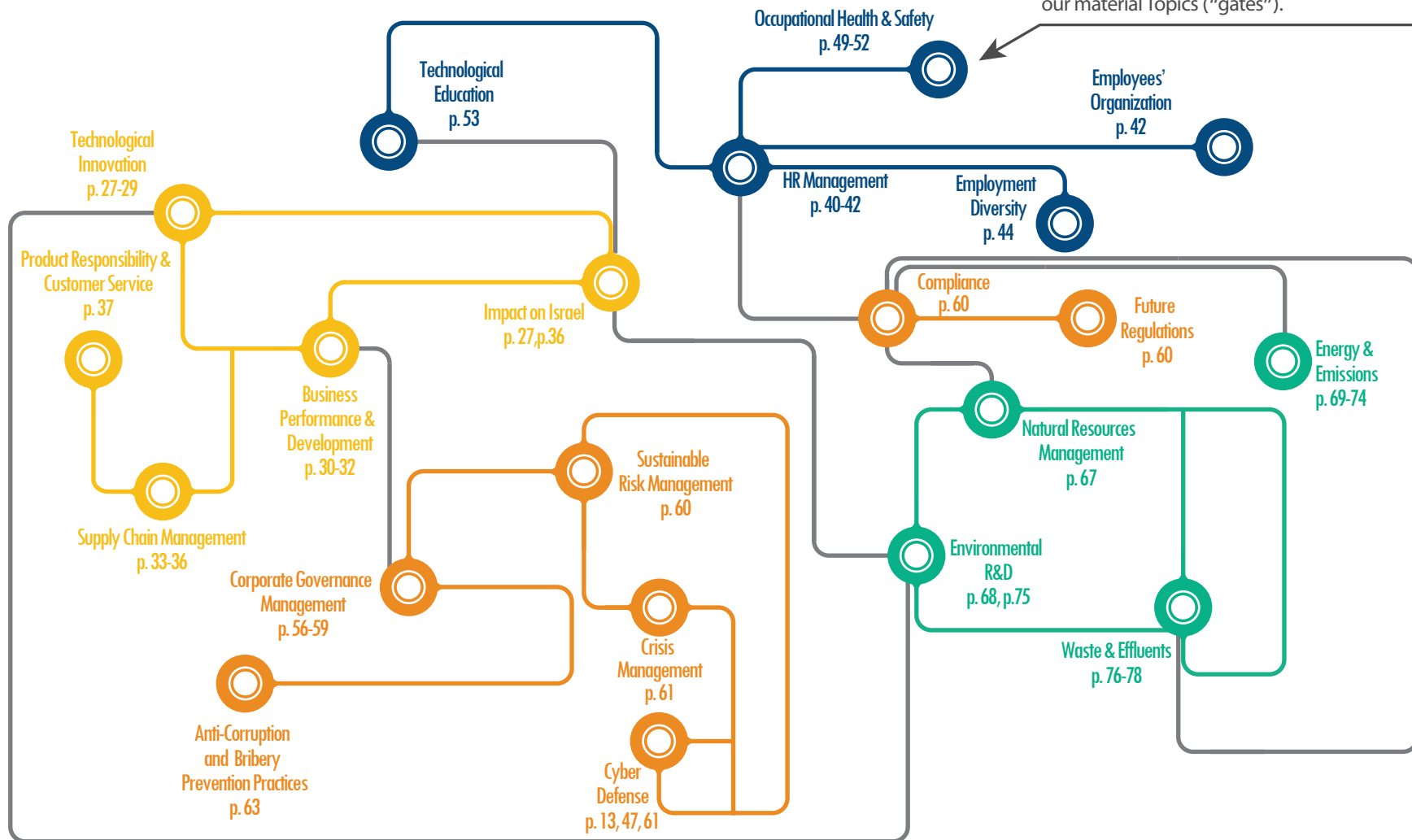# Setting IAI's long term sustainability goals

Limited Assurance

Looking ahead, IAI is aiming to expand its sustainability goals in the long run, as well as aligning with important national and international sustainable development roadmaps and initiatives. We are currently in progress of formulating our long-term sustainability goals as part of the company's overall business strategy, and the clear and detailed roadmap that will lead us to achieving them. Therefore, we have decided to set these goals as part of the company's 2023 strategy. The goals will take into account multiple inputs – our material issues, Aerospace and defense (A&D) industry goals, stakeholder feedback, global mega-trends and the UN SDGs. We expect to publish our commitments in our 2018 sustainability report.

2018
Assessing and solidifying our 2023 goals

2019
Publishing our 2023 goals in our 2018 report

Global Mega-trends

Stakeholder Feedback

A&D Industry goals

The UN SDGs

IAI's material topics

IAI 2017 sustainability goals → IAI 2023 sustainability goals

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Innovation and Economic performance	Social Responsibility	Corporate Governance	Environmental Management
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PART 1

Innovation and Economic Performance

Arrow 3 (Hetz) missile system

In 2017, the Israeli Defense award was granted to the developers of IAI's arrow 3 missile system and their respective launch control center (LLC) and launcher. The arrow 3 development project began in MALAM division, a part of the Systems, Missiles and Space Group, roughly ten years ago.

The Arrow system is the world's first operational, national, stand-alone ATBM (Anti Tactical Ballistic Missiles) defense system. Based on the uniquely effective Arrow 2 and Arrow 3 interceptors, the Arrow modular air defense system detects, tracks, intercepts and destroys incoming TBMs carrying weapons of mass destruction and over a large footprint, thereby protecting strategic assets and population centers.

The arrow 3 specifically, is an anti-ballistic missile, which provides an exoatmospheric interception against the newest long-range threats. It has a compact and innovative design and two advanced propulsion systems with superb maneuverability and divert capabilities, and was developed as the upper tier defense in the multi-layer aerial defense of Israel.

Unique innovations that became operational in 2017

Material Topic

A single aero-structures assembly in one shot

The aerospace industry continues its relentless quest to minimize both cost and weight of aircraft, thus raising the company's competitiveness as well as lowering the overall environmental impact of commercial aviation. The conventional production process for aero-structure assembly relies on attaching several components through fasteners.

IAI's Aero-structures assemblies Division in the Commercial Aviation Group, in collaboration with IAI's Engineering and Development Center, have developed an innovative technology which allows the production of an entire aero-structures assembly in one process, or "one-shot", using a fully automated production line which consists in automatic manufacturing and quality verification of the product.

In this technology, the assembly is manufactured from composite materials, and includes a combination of unique facbric which constitutes the product's skeleton, and special resins injected and molded under specific conditions of heat and pressure. On the first stage, the technology was used to manufacture helicopter seats, and efforts continue to be invested toward the automatic manufacturing of rudders and stabilizers in tail assemblies.

Since most of the process is automatically performed, many of the original assembly steps were eliminated achieving a 100% repeatability of the process and improved product quality. The solution demonstrated a 30% decrease in cost and 20% decrease in total weight, compared with the traditional process.

Unique innovations that became operational in 2017

Printing 3D parts for space

IAI's Systems, Missiles and Space Group installed a large metal 3D printer with the aim of maximizing the parts' design and configuration by optimizing their topology for best results of weight-to-payload. This optimization process takes into consideration all the different engineering constraints, such as the raw material used, its volume, all potential interfaces etc., thus allowing to print any part or system component in its most beneficial form, while ensuring it will meet all the technical requirements and standards of being sent to space. 3D metal printing also allows the integration of several subcomponents into a single-printed unit, saving the phase of assembly, as well as the use of additional parts for secure connection.

The optimization process was already put to use in the group's products, allowing saving about 2 kg of its final weight, a meaningful number when dealing with parts that require shuttling into space, total material use, and from cost perspective.
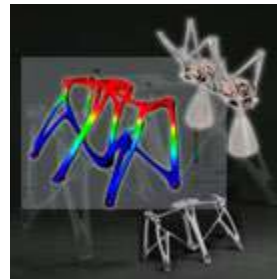
Financial Performance

Material Topic

IAI is a global Aerospace and Defense company, the largest A&D Company in Israel, and ranked 33 out of 100 companies in the international A&D sector 2017 index by Defense News.

The Government of Israel holds 100% of the shares of IAI.

The company's financial statements have been prepared in conformity with IFRS, and fully comply with the Israeli Securities Regulations and the Israeli Government Companies Law – 1975.

Financial item	2017 (Million US $)	2016 (Million US $)	2015 (Million US $)
Net Sales	3,520	3,577	3,708
Tax Income	0	28	0
The total economic value produced (income):	3,520	3,605	3,708
Operating costs (including salaries and benefits)	3,399	3,682	3,661
Finance Expenses	29	41	24
Tax Expenses	8	0	13
Dividends	5	0	9
The total economic value distributed:	3,441	3,723	3,707
Total economic value gained*	79	-118	1
Net income	81	-110	9
Government support: R&D grant by the Chief Scientist in the Ministry of Economy	5	9	14

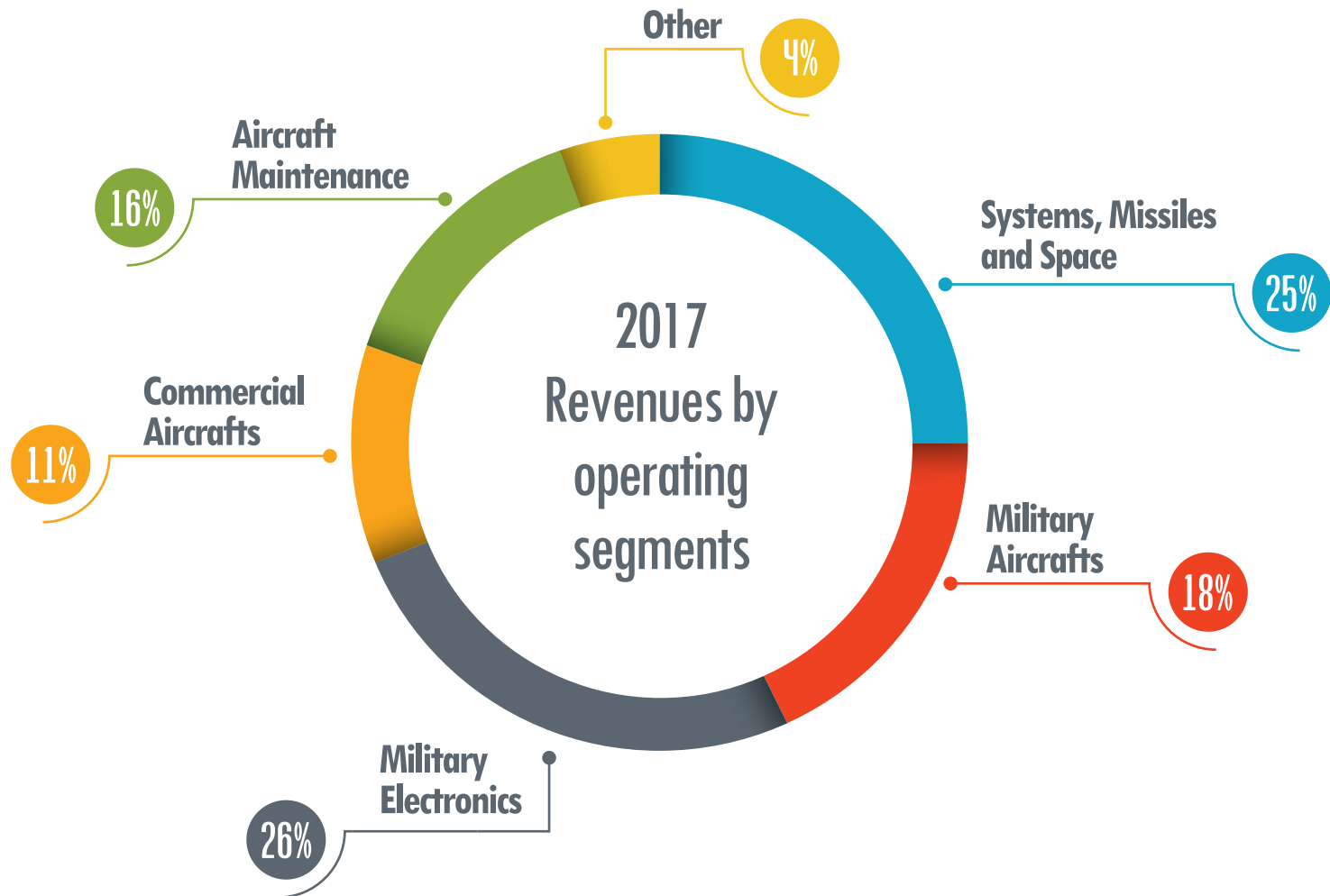* Calculated as total value produced less total value distributed.

On December 31, 2017, IAI held a backlog of order amounting to 11.2 billion US $ that equals to 3.2 years of activity.

Total company equity stands at 993 million US $ and total company debt stands at 3,958 million US$.

As a governmental company, IAI is not allowed to donate in accordance with section 17 of the Israeli Government Companies Law - 1975.

2017 Revenues by operating segments

- Other — 4%
- Systems, Missiles and Space — 25%
- Military Aircrafts — 18%
- Military Electronics — 26%
- Commercial Aircrafts — 11%
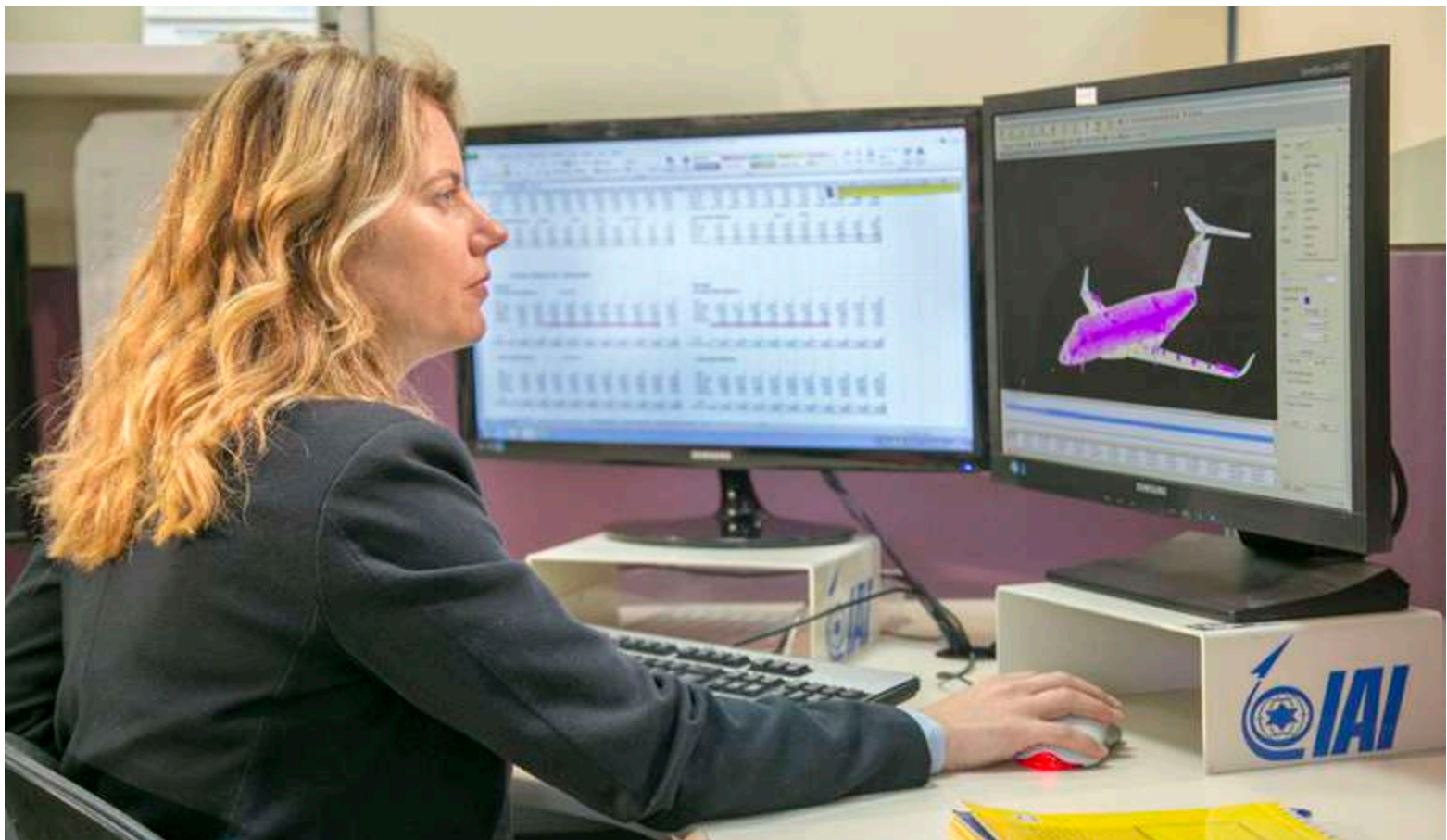- Aircraft Maintenance — 16%

Business Development

103-1 | 103-2 | 103-3 | 102-6

Material Topic

The goal of IAI's Business Development Organization is to identify and develop new business areas and markets, where IAI can achieve a relative advantage. In addition, the organization is responsible for forming a business growth strategy, maximizing IAI's sustained competitiveness and position as a dominant leader in its core businesses.

The major instruments used to carry business development into effect are: establishment of joint ventures creating added value through business synergy; acquiring required technologies for continual development; offering business support for innovative programs; converting military technologies to civilian applications; setting up technological hubs and gaining finances through venture capital funds.
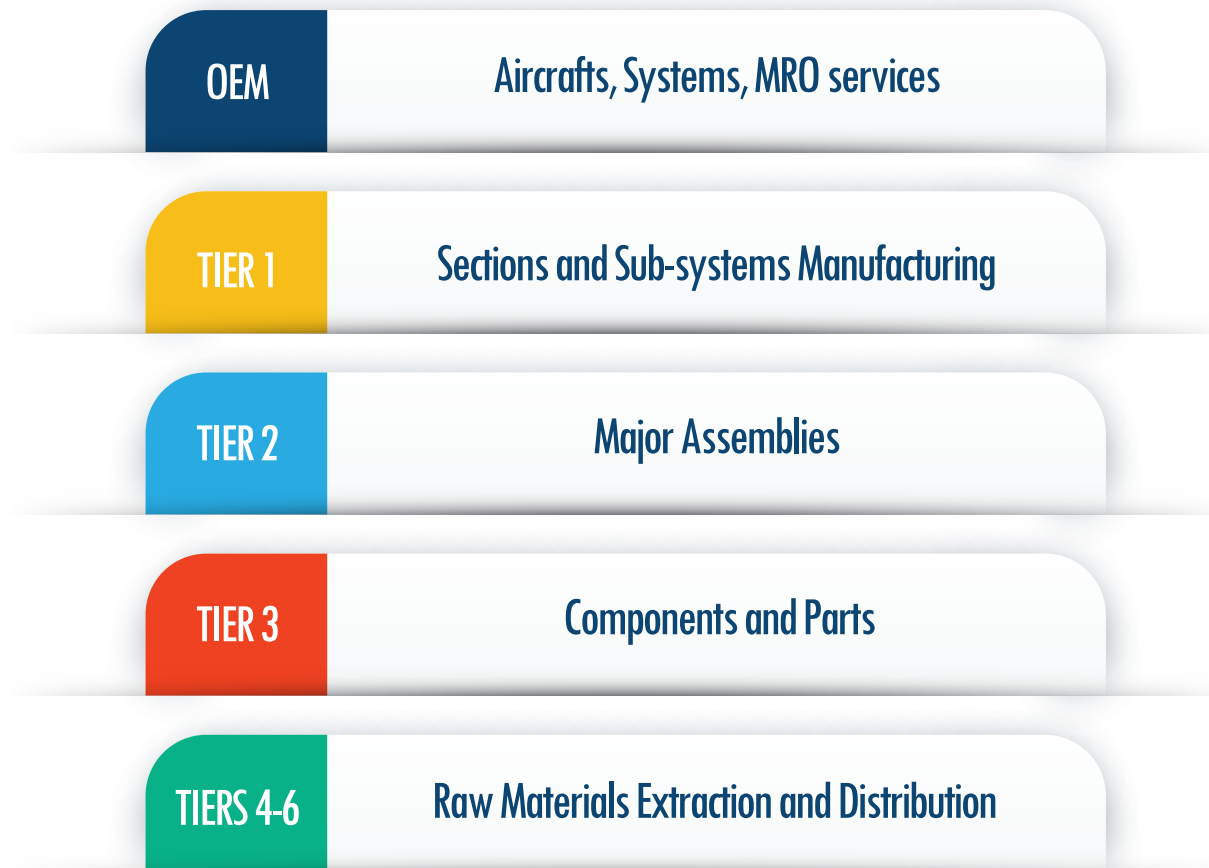
IAI's Supply Chain

Material Topic

The Aerospace and Defense industry has a highly complex and dynamic network of suppliers, requiring effective management of costs, quality and delivery timelines. The constant flow of materials, data, and money presents many opportunities for sustainable thinking. A&D Original Equipment Manufacturers (OEMs) play a critical role in setting the expectations and leading the suppliers and subcontractors in following humane practices, implementing economic values and achieving environmental excellence.

OEM	Aircrafts, Systems, MRO services
TIER 1	Sections and Sub-systems Manufacturing
TIER 2	Major Assemblies
TIER 3	Components and Parts
TIERS 4-6	Raw Materials Extraction and Distribution

A&D Generic Supply Chain Structure

IAI's Supply Chain
102-9 | 103-1 | 103-2 | 103-3

Material Topic

IAI is a unique player in the A&D supply chain, since it serves as the OEM for some of its products and as a Tier 1, 2 and 3 supplier for others. As such, IAI is exposed to an intricate network of relationships and has varying degrees of impact on the sustainability practices of its suppliers. Regardless of IAI's position in a certain product's supply chain, we believe that raising the bar translates into higher standards for all those who engage in business with us.

As an OEM, IAI is working only with TIER 1 suppliers that are certified by our company. These suppliers are obligated to hold valid and current permits, authorizations, and standard certifications relevant to their business. In addition, IAI is investigating their economic stability prior to engagement and continues to track their financial performance throughout the entire business relationship. We are now moving to implement these same requirements from our TIER 2 suppliers.

Suppliers Certification Process

Both the supplier certification process and the continuous quality assurance procedures are set and supported by IAI's Quality Assurance Organization. These include, inter alia:

>> A Central system for supplier quality assurance management, designed to assure that the quality of the products supplied meets IAI requirements, and includes the implementation of any follow-up requests. Our goal is for all our suppliers to embrace the same standards and commitments that IAI has set for itself as a supplier to other OEMs.

>> An online Suppliers' web portal, containing all the data and information required by suppliers that engage in business with IAI. Through this portal, the suppliers report on any use of sub-contractors and TIER 2 suppliers, thus enabling higher levels of supply chain transparency and control.

>> Keeping our Israeli supply base up-to-date through different initiatives regarding requirement changes, supplier delivery schedule, accounting and billing through e-sources. This significantly minimizes the use of paper, and makes the transfer process more efficient and much shorter.

IAI's Supply Chain

IAI's Procurement and Logistics (P&L) Organization sets structured processes and mechanisms demonstrating the triple-bottom-line combined with ethics and governance.

Economic

Expanding and adding to our over-arching framework agreements, in both operations and project management, to take advantage of our economics of scale and yield higher rates of savings. Savings are further achieved by maximizing the standardization across the company for purchases of items such as furniture, cell phones, printing materials etc.

Environmental

Setting annual savings, inventory values and circulation targets for raw materials, utilities and resource procurement through the use of a database system and by blocking the option for purchasing items marked as superfluous.

Social

Supporting local suppliers ("Buying Blue-and-White"), small businesses, and suppliers from rural areas as a strategy, to augment their capabilities and share in the global A&D industry.

Ethics and Governance

P&L personnel training includes codes of ethics, organizational culture as well as interpersonal communications, with special emphasis on interactions with suppliers for the mutual development of quality products and maintaining long-term, fair and honorable partnerships.

Local Procurement

Material Topic

As a governmental company interwoven with Israel's welfare, IAI is striving to encourage the development of Israel's economy in general, and in the country's rural areas in particular. This is locally known as "buying Blue-and-White", as the colors of Israel's flag.

In 2017, we have spent 62% of our total annual procurement, buying from Israeli suppliers. This is the second year in a row of improvement in our "Blue-and-White" procurement.

The majorities of our suppliers overseas are engaged based on economic grounds, expertise, and requests of our customers, or by the terms of reciprocal trade (offset obligations). Through these same relationships, IAI has also obligated its foreign suppliers to further expand their procurement from Israeli sources, a requirement covered by the Israeli Mandatory Tender regulations - 2007, in full partnership with The Industrial Cooperation Authority at the Ministry of Economy and Industry.

Bar chart showing % local procurement by year:
- 2015: 52
- 2016: 61
- 2017: 62
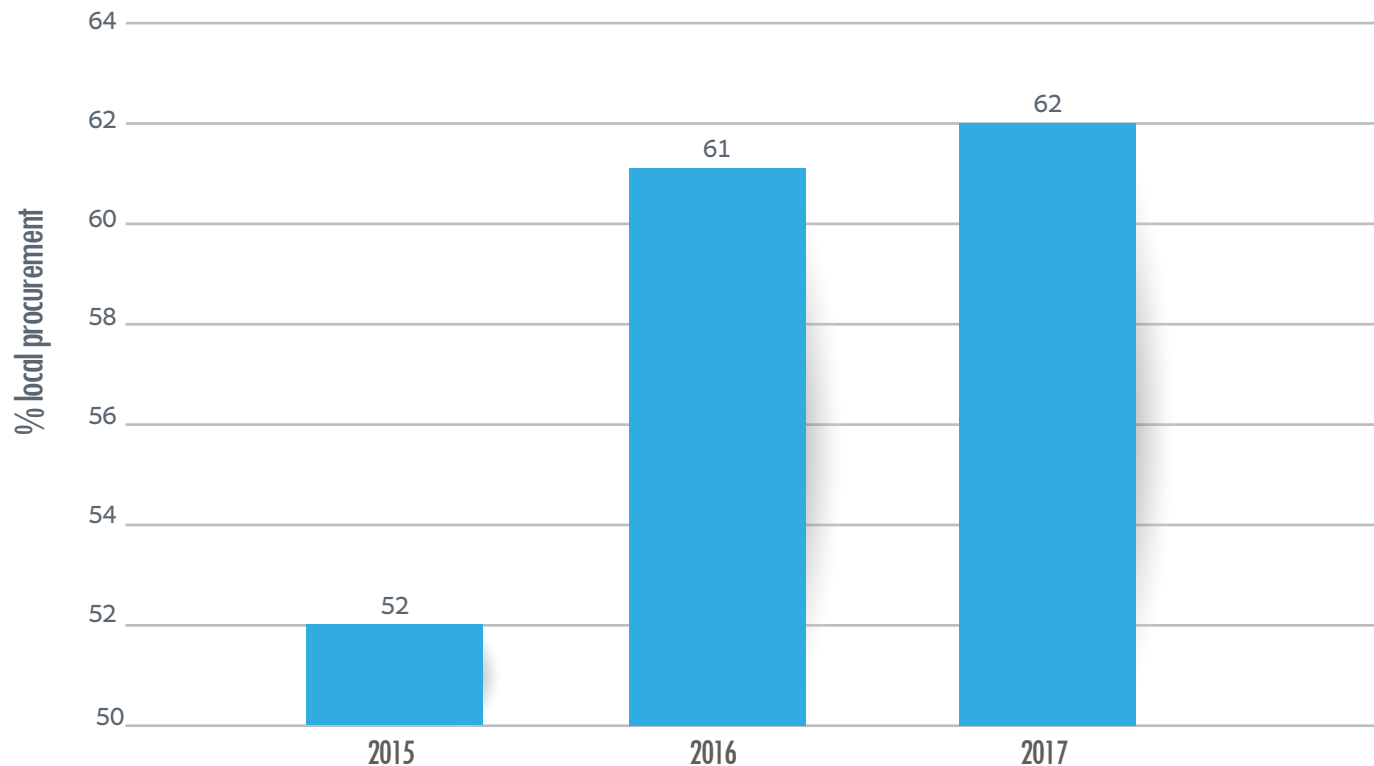
Product Responsibility and Customer Service

103-1 | 103-2 | 103-3 | 417-1

Material Topic

IAI is fully committed to serving all its customers, past, present and future. A key feature of this service is Product Responsibility and Customer Support. Each IAI operating Division is the primary customer support contact for all products and services provided by the company.

Our customer service Pledge

>> IAI views the customer as its long-term partner

>> IAI's management views customer satisfaction as a supreme value and is thoroughly committed to achieve it.

>> IAI shall invest top effort to understand its customer's needs and to respond to the same with suitable solutions, while maintaining high quality, standards and schedules.

>> IAI shall promptly respond to its customer requests and will coordinate the provision of support and assistance to derive the utmost efficiency from its products in their life cycle. Towards this goal, IAI shall make available the required resources and infrastructure.

>> Customer feedback shall guide IAI in its continuous quest to improve the quality of its customer support, communication and level of satisfaction.

PART 2

Social Responsibility

IAI's Social Responsibility

103-1 | 103-2 | 103-3

Material Topic

IAI is based on extraordinary people leading technological breakthroughs on a daily basis. Very few companies in Israel are so intertwined with the development and prosperity of this country, and our "Israelism" is reflected through our invaluable relationships with our employees, retirees, customers, contractors, suppliers, and the communities we live and operate in.

2017 carried over many of the challenges from 2016, in terms of our social responsibility. As we completed our parting with 730 employees as part of the growth agreement signed in 2016, a difficult step on our journey, serving also as an opportunity for us to practice deep caring in the face of hardship. The HR organization, along with Senior Management and the Employees' Organization have worked relentlessly to establish a smooth retirement process for the departing employees, with an array of supporting tools and consultations. Our employees continue to be the heart and soul of our business, and this is more notable when such crossroads appears.

2017 brought into fruition the new focus areas defined in 2016, all designed to take IAI to the next level of organizational development, while solidifying the HR Organization's primary mission as a supporting organization, in **connecting to people and tuning into business to enhance performance.** From the completion of the first cycle of LeadAir, and future management training, through achieving diversity goals, to knowledge retention activities, and a strategic plan for cross-organizational women advancement.

IAI's Social Responsibility

Directorates leaders forum	LeadAir Program 1st cycle	Middle management empowerment	HR Best practices pilot
Managing future personnel composition as company risk	New orientation process for new employees	Infrastructure implementation for retention of retirees' knowledge	Developing work economy (salaries and benefits)
Growth 2016 agreement support	Consolidated HR unit for the Commercial Aviation Group	Meeting the 75%:25% goal in community involvement	Strategic program for women advancement
	Validation of IAI's organizational needs	Developing an effective organizational discourse	

Components* of our social responsibility program

* Further details of these components are presented throughout this chapter.

IAI's Social Responsibility

103-1 | 103-2 | 103-3

Material Topic

We continue to provide extensive training and personal development programs, scholarships, position transfers, innovation hubs and general wellbeing activities, and retirement through tailored processes designed to accompany the employee during outplacement or pension. In 2017, IAI ranked 6th "best place to work" in Israel's BDIcode INDEX.

We keep our long term commitment to a great work environment; from in-house service facilities such as large catering halls, banking, employee transportation, gym and synagogues, through health care offered by our 24/7 occupational health clinics and social workers, to processes and training programs to advance active listening and enhance internal communications. Strategic focus is also placed upon the advancement of women through all echelons of the organization, by encouraging promotion to management roles. Also, specific opportunities are established for the integration of employees with special needs in IAI's work environment.

We remain firm in our belief that community outreach is invaluable for our business, and continue to support local communities through thousands of volunteering hours, and programs such as the developers group and other initiatives. Our resolve to support Israel's society, both through our technologies and our people, is indeed the source of our true value.
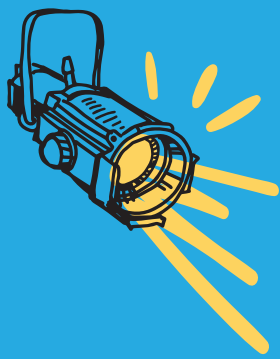
IAI Spotlight

The Developers Group

The Developers group was established in cooperation with Tikkun Olam Makers (TOM) non-profit organization, with the aim to partner a team of developers with a person with disabilities, in order to create a unique innovation that will solve a specific challenge experienced by that person. The 1st developers group was comprised of 60 IAI employees, divided into 13 working projects.

Each team had developed a product that would benefit and ease the lifestyle of the disabled person, while focusing on technological solutions that either do not exist in the market, or are very expensive for people to afford.

Among the projects were: A mechanism to allow easy stretching of the Achilles tendon, Self-securing wall climber, Tray to go that allows an employee to easily carry his lunch tray while mounted on crutches, a carrier cart for life support equipment, an accessible box of tissues on a wheelchair, accessible waste bins, and a device that allows a person with disabilities to do kite-surfing.

The developers' team won 1st place in collaboration with TOM (Tikun Olam Makers), for excellence in community care activities category, at the national competition organized by the Israeli non-profit organization for management, development, and research of Human resources.

Empowering our Employees

Material Topic

IAI remained the largest governmental employer in Israel in 2017, with 14,857 employees in total, including permanent and temporary employees, as well as contracted employees, students and apprentices. All of our permanent employees (64.3%) are signed under collective agreements.

	Total			Women			Men		
	2017	2016	2015	**2017**	2016	2015	**2017**	2016	2015
Number of employees	**14,857**	15,359	15,734	**3,156**	3,199	3,235	**11,701**	12,610	12,499

Employee Diversity

Material Topic

IAI continues to actively diversify its workplace and promote equal opportunities in employment. We look to further expand our program for intake of Israelis of Ethiopian origins, as well as members of the Orthodox jews and Druze communities. In addition, IAI is setting no limits regarding workers' age, and regularly welcomes employees over 45, such as IDF retirees.

In 2017, IAI's proportion of women as a percentage of the total workforce increased to 21.2%. The Sustainability Board committee and the Senior Management Steering Committee for sustainability chose IAI's women's advancement program to be continued as one of the company's major focus areas for 2018 (see page 22).

A decrease was noted regarding employees with disabilities in the company. The drop is attributed to age-retirees leaving the company, as well as some employees that were included in the 2016 growth agreement between IAI's management and the employees' organization.

	% Total		
	2017	2016	2015
Employees from Ethiopian origins	**1.6**	1.5	Not reported
Employees from the Druze community	**0.1**	Not reported	Not reported
Employees age < 30 years	**11.7**	10.7	8.5
Employees age 31-50 years	**51.6**	45.2	43.8
Employees age > 51 years	**36.7**	44.1	47.7
Employees with disabilities	**2.5**	3.3	3

Empowering our Employees

Objectives and targets were set with specific cross-organizational referents from the company's HR organization, to support and actively promote the intake process for each unique group.

Management Diversity

Material Topic

IAI is striving to change the traditional management composition that typically rules defense and technology companies worldwide, by gradually expanding the number of women in its Senior Management roles. This requires long-term investment in training and advancing skilled women from junior management roles. Currently, 8.66% of the top 10% salary-level represents women.

A notable decrease in the total number of managers occured between 2015-2017, as part of the organizational changes following the 2016 Growth agreement.

The proportion of senior management hired from the local community is 100%.

	Total			Women			Men		
	2017	2016	2015	**2017**	2016	2015	**2017**	2016	2015
Number of Managers*	**58**	59	68	**7**	8	6	**51**	51	62

* This includes vice presidents and direct reporting to CEO.

Age Group	% Total		
	2017	2016	2015
Managers age < 30 years	**0**	0	0
Managers age 31-50 years	**27.6**	20.3	16.1
Managers age > 51 years	**72.4**	79.7	83.9
Managers with disabilities	**8.6**	Not reported	Not reported

Empowering our Employees

404-1 | 404-2 | Limited Assurance

Employees Training and Development

IAI invests extensively in training its employees and establishing a long-term development plan for their continual individual evolution within the organization.

One of our operational divisions is MHT, which, among other responsibilities, is our powerhouse for training both in-house and external trainees in numerous general and expert-specific courses. It offers technical, aviation, and management raining for employees at different levels of knowledge and experience, serving as a meaningful tool to help employees in their career development at the IAI, as directed by our Human Resources organization. MHT is also considered a certifying and registration entity on behalf of the Israeli Aviation Authority, the American Federal Aviation Administration (FAA), and the European Aviation Safety Agency (EASA). Training is available as frontal and online courses, and is utilizing IAI's INTRANET for tracking completion of both mandatory and elective requirements. We conduct academic studies towards practical engineering and Bachelors level degrees within our facilities, and support collaborations with, authorized academic colleges and universities in Israel for the accreditation of Master's and Doctorate level degrees for our employees.

Our training programs are designed to support:

>> New employee orientation (including safety, occupational health and ethics)
>> Professional and managerial level training to advance employees through roles from the bottom-up
>> Annual Refreshers on mandatory topics
>> Regulatory-required training
>> New technologies instructions
>> IAI's future managers training (LeadAir)
>> Career change classes
>> Retirement readiness
>> Enrichment courses
>> Academic bachelor's, master's and doctorate degrees

IAI's company-wide training continues to be evaluated by the training effectiveness system, established in 2016. The evaluation of training effectiveness is supported by the certifications IAI holds, including: ISO 9001:2015, AS9100, and CMMI.

	2017	2016	2015
Total number of training hours*	**547,730**	495,562	431,902
Average number of training hours per employee**	**37**	33	27

* Represents frontal training only, excludes additional training completed via web.
** Normalized per total number of IAI's employees (see page 44).

Empowering our Employees
201-3 | 404-1 | 404-2

Cyber cadets

IAI's cyber division, in collaboration with the MHT training center, have launched the first training course for cyber cadets, designed to build an "elite squad" to manage the most challenging cyber space threats and future trends. The 3-months course consisted of both business and academic knowledge and skills, and used an innovative simulation learning space for cyber scenarios.

Employees Benefit Plans

IAI's employee benefit plans and pensions are reported in the 2017 Financial statement, Note 3 section (m), pages 39-41.

Medical Care and Coverage

IAI operates internal clinics for occupational health and immediate medical care at its sites, available to all employees. In addition, each permanent employee owns an extensive medical insurance and has an option to insure his family members at discounted premiums. Furthermore, all employees are entitled to a once-a-year medical checkup, for early detection of various illnesses and their prevention.

Working Mothers

In addition to complying with all legal requirements (such as a paid, daily 1-hour off for breastfeeding), special attention is bestowed on working mothers returning from their maternity leave:

>> Designated working schedules for working mothers

>> Designated transportations for mothers of children up to 8 years old, facilitating early pick-up from daycare and schools

>> IAI is sharing in daycare costs for employees with young children.

Human Resources (HR) excellence awards

Two HR teams from IAI were awarded for excellence in the national competition organized by the Israeli non-profit organization for management, development, and research of Human resources. IAI's developers' team (see page 43) in collaboration with TOM (Tikun Olam Makers), a non-governmental organization, won 1st place. The 2nd place was awarded to the team led by the executive VP HR, after winning first place on IAI's LeadAir training program, designed to develop the company's future generation of managers. The first participants completed a 10-months training program in 2017, with some receiving the role of division managers upon graduation.

Organizational Transitions

New Employees

In 2017, IAI has welcomed a total of 1,151 employees, the balance between the number of retirees and new employees stood on 417 workers.

In addition, 16% of our employees were promoted within the organization during that year.

Number of new employees	Total			Women%			Men%		
	2017	2016	2015	**2017**	2016	2015	**2017**	2016	2015
	1,151**	932*	864	**28.3**	31.9	33.9	**71.7**	68.1	66.1

* Out of which 411 are students.
** Out of which 434 are students.

Age Group	2017	2016
Employees < 30	**687**	580
Employees between 31-50	**369**	283
Employees > 51	**95**	69

Approximately 98% of all professional contractors that were employed for 9 months in 2017, and were granted a good performance reviews, became a direct company employee.

Retiring from IAI

IAI has an extensive program for its retirees covering both early- and age-based retirement, aimed to ensure a smooth transition to their new life phase, including:

>> 4-day retreat for retirees and their spouses, covering lectures and workshops around the impact of retirement on family life, retirees' social security rights, savings and pension, rights reserved specifically for IAI retirees and ways to maintain contact with the company, volunteering opportunities, impact on relationships, health care, etc. Top management representatives join some of the sessions for Q&A – the company's President and CEO, the chairman of the employees' organization, the Company's Executive VP HR and others. This program was attended by 99% of our retiring employees in 2017.

>> A retiree club, open to all retired employees, where they can access specific guidance, as well as continue enjoying activities such as tours, travels, and courses.

>> A newsletter is issued periodically to all retirees, keeping them up-to-date with all the company's latest news and stories.
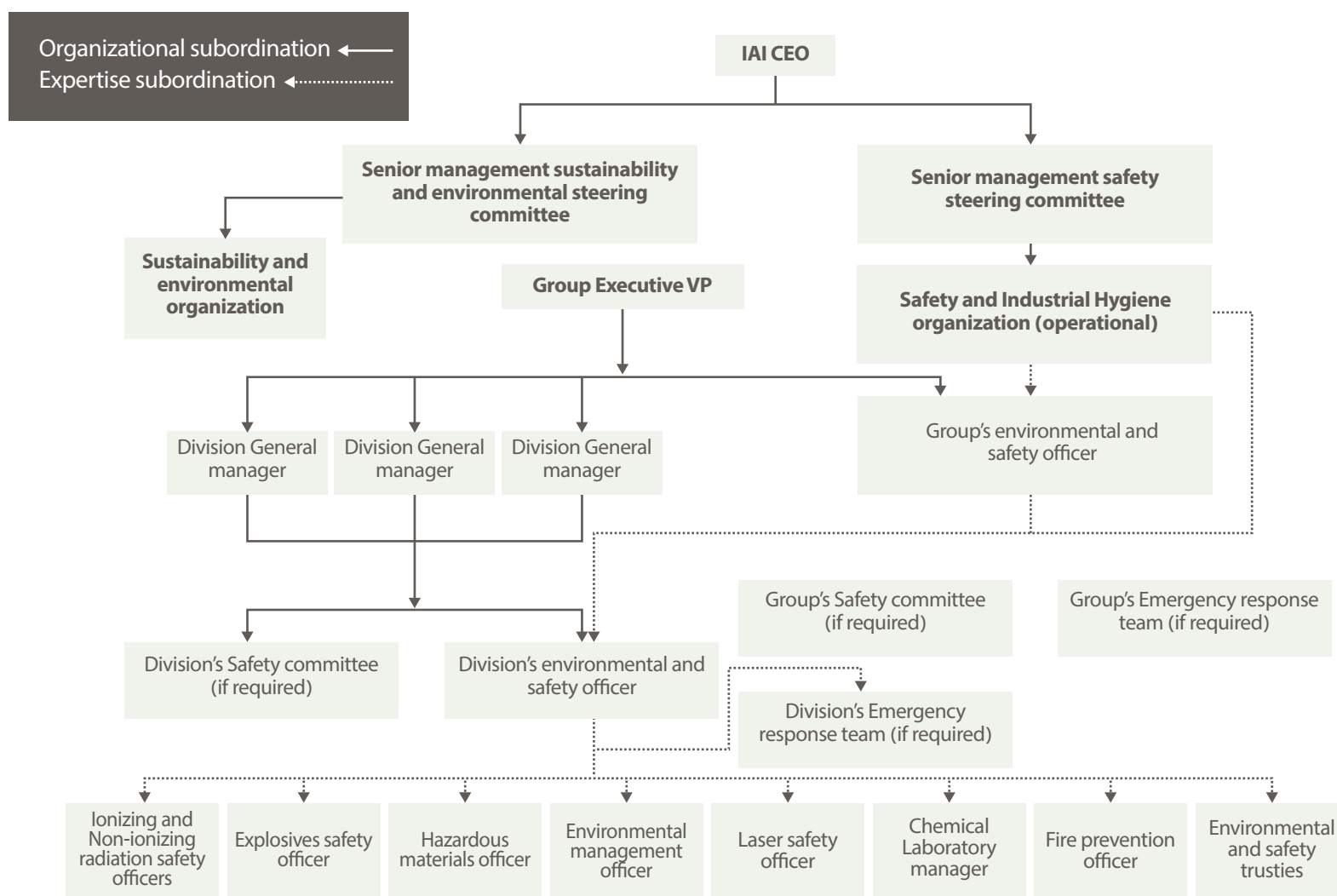
Occupational Health and Safety

103-1 | 103-2 | 103-3 | 403-4 | Limited Assurance

Material Topic

Occupational Health and Safety Management at IAI

IAI's Safety, Health and Environmental issues are operationally managed at all levels in a matrix responsibility and reporting organization, and overseen by a Senior Management Steering Committee.

Occupational Health and Safety

103-1 | 103-2 | 103-3 | 403-1 | 403-2 | 403-4 | Limited Assurance

Expert Safety, Health and Environment committees were formed to establish specific guidance and training requirements for issues identified as major aspects. These include: establishing safety procedures and work instructions, compliance with laws and regulations, environmental management, hazardous materials, contractors safety, aviation safety, explosives safety, noise, electromagnetic radiation, ionizing and laser radiation, elevation tools, electricity and electrical tools, construction safety, ergonomics, personal safety equipment, accessibility, event safety, maintenance safety, microwave products development safety, catering and food safety, cleaning safety, chip processing safety, production route card and handling of general hazards.

Compliance with OSHAS 18001

All IAI's operational divisions own valid business licenses and OSHAS 18001 certifications. The company enlisted with an online service for safety and environmental laws and regulation updates, and all divisions maintain annual safety and environmental programs based on ISO 14001 and OSHAS 18001 guidelines. The Safety Management System (SMS) is operated for continuous improvements with periodic surveys and management reviews, and a designated annual budget committed by all division managers.

IAI continuously reviews all required ISO standards in our EH&S programs and follows any relevant transitions to their most updated framework , as acceptable in the A&D sector.

The divisions' safety committees comprise of 50% management and 50% employee representatives from the employees' organization. Safety and occupational health issues are handled on an annual basis as part of the company's safety plan, and derived from the joint collective agreements between management and the employees' organization.

Occupational Health and Safety

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Table: Number of accidents and direct employees' absence days due to either injury or sickness*

Group	No. Accidents**			No. Absence days		
	2017	2016	2015	**2017**	2016	2015
BEDEK aviation	**47**	44	37	**1,741**	1,487	857
ELTA systems Ltd.	**14**	16	14	**269**	485	428
Engineering and Development	**5**	2	7	**122**	71	98
Systems, Missiles and Space	**16**	17	18	**297**	578	557
Commercial Aircraft	**14**	18	21	**589**	619	906
Military Aircraft	**4**	4	10	**142**	289	388
Supporting units***	**1**	5	6	**18**	159	48
IAI Headquarters	**2**	4	4	**76**	191	112
Total	**103**	110	117	**3,254**	3,879	3,394
Total per 1000 Employees	**6.9**	7.2	7.4	**219**	253	216

* The data represented in this table is based on a cut-off analysis from April 2018. Some of the data that appeared in earlier reports may be restated due to safety system update with late-reporting of events, as the Israeli law allows a 5-year intervals for accident reporting.
** The data excludes traffic safety accidents, which are reported separately (see page 52).
*** Industrial Services, MMN (IT services), and MHT.

There were no work-related fatalities at IAI in 2017. A decrease was noted in IAI's total safety performance indicators between 2016 and 2017, following substantial efforts invested. The Sustainability Board committee and the Senior Management Steering Committee for sustainability have chosen IAI's Safety and Health program to be continued as one of the company's major focus areas for 2018 (see page 22).

Contractors and Suppliers Health and Safety

IAI includes Occupational Health and Safety practices clauses in all contracts. Further information regarding these aspects of the supply chain will be presented in future reports.

Table: Number of contractors accidents*

2017	2016	2015
10	21	24

* Data is based on insurance claims only.

Occupational Health and Safety
403-2

Traffic Safety

IAI's operational areas are extensive, with an intensive presence of a variety of vehicles – from freight trucks and aircraft towing vehicles to private cars, all the way down to forklifts, small scooters, and bicycles. IAI also operates a car fleet for short employee travels between its sites and a leasing car fleet for employees. A designated Traffic Safety Organization, established in 2016, manages all transportation requirements, ensuring adherence to traffic laws and regulations, performing traffic accident investigations, and follow up traffic accidents and speeding incidents, and continually improve our transportation systems.

The major improvements in 2017 included:

>> Expanding the entrance road to IAI's main campus, including new signs and road markings.

>> 10% fewer reports, compared to 2016, were submitted through "NOHAL 6", a system documenting violations reported by anonymous road drivers while IAI's vehicles travel outside the campuses.

>> 60% fewer violations were noted in TRAFFILOG, an INTRANET-based system used to document and record speed limits exceeding, compared to 2016 performance.

>> Optimization of parking spaces, with 200 new parking spots established and appropriately marked.

>> In 2017, 118 parking tickets were submitted by the internal traffic safety enforcement unit, where trained members are patrolling the sites twice daily, enforcing traffic regulations, and safety instructions in parking and driving. Some of those reported appeared before a hearing committee due to their risky driving behavior.

	2017	2016
Number of Traffic accidents (insurance activated)	28**	59*
Number of pedestrian injuries	6	6

* comprised of 27 accidents with insurance activation and 32 more accidents without insurance activation that were internally investigated.
** comprised of 17 accidents with insurance activation and 11 more accidents without insurance activation that were internally investigated.

Community Involvement and Volunteering
413-1

Our commitment to communities located in the vicinity of our operations, as well as to the Israeli society as a whole, remains solid. The invaluable sense of giving and positively influencing the lives of those who look for a change in their life circumstances is motivating many of our employees to continually reach out. 5.2% of the company employees are long-term volunteers, averaging 20 hours per each volunteer. In addition, about 5,400 food packages were donated to families in need in the Jewish holidays of Hanukah and Passover.

In 2017, a total of 16,233 volunteering hours was recorded. The decrease in volunteering hours from 2016 is attributed in part to overall company changes and transitions occuring in 2017.

At the end of 2015, the goal set for our community involvement and volunteering was 75%: 25% division of activities between volunteering in technological education and supporting weakened communities in need, respectively.

Volunteering focus	% of activities, 2017	% of activities, 2016	Annual goal for % of activities
Technological education	42	65	75
Weakened communities in need	58	35	25

In 2017, we did not succeed in meeting our goal relating to the number of volunteering activities focusing on technological education. As we move to define our 2023 sustainability goals (see page 23), we expect to re-assess the goal set in 2015.

PART 3

Corporate Governance

Corporate Governance at IAI

103-1 | 103-2 | 103-3 | 102-18 | 102-22 | 102-26 | Limited Assurance

Material Topic

IAI's Corporate Governance Structure

Israel Aircraft Industries ("IAI") is a private corporation wholly owned by the State of Israel, (i.e. A Government Company as defined in the Government Companies Law – 1975 (hereinafter – "the Government Companies Law")). In 2007 IAI conducted its first public offering of debt and became a reporting corporation. The Government Companies Law stipulates various instructions and corporate governance rules which are effective for the Company as a Government Company, including, inter alia, instructions regarding the composition of the Board of Directors and its work, the powers of the Board of Directors, qualifications of the Directors and the method of their appointment, Directors' compensation, and rules ensuring the accuracy of the financial statements and the Director's Report. The rules of the Companies Law -1999 (hereinafter – "the Companies Law") apply to the Company subject to the rules of the Government Companies Law. The Articles of Association of the Company are included in a prospectus published on December 29, 2011 (Document No. 2011-01-379344).

As it is a "reporting corporation" the Company is also subject to the rules of the Securities Law – 1968. IAI applies corporate governance principles in accord with its standing as a global company, active in the defense and global aviation sectors.

The regulatory entity to which IAI is subordinated is the Government Companies Authority. The Company maintains current communications with the Government Companies Authority, inter alia, through a representative of the Authority, present at meetings of the Company's Board of Directors.

The Company's Board of Directors and its Committees

Company's Board of Directors is responsible for outlining the Company's policy and for supervising its management activities.
The Company's management is in charge of implementing these policies in practice and for reporting to the Board of Directors.

In 2017 the following Board of Directors' committees were active: (I) Financial Statements and Investments Committee, (II) Audit Committee, (III) R&D and Strategy Committee, (IV) Sustainability, Corporate Governance and Advancement of Women Committee, (V) Commissions Committee, (VI) Remuneration Committee and Personnel Committee.

The Company's Sustainability Committee was established in 2012 (currently the Sustainability, Corporate Governance, and Advancement of Women Committee). The committee's responsibilities regarding sustainability and corporate governance are - corporate responsibility; corporate governance; sustainable development; an internal enforcement of the securities laws.

Corporate Governance at IAI

102-18 | 102-22 | 102-26 | Limited Assurance

Members of the Board of Directors of the IAI are appointed by the Minister of Defense and the Minister of Finance in consultation with the Committee for the Examination of Appointments of the Government Companies Authority. Candidates for Directors in Government Companies are chosen from a pool of Directors identified by the Government Companies Authority as part of the "Directors Team" project launched in 2013. The candidacy and qualification of the Directors are verified by the Committee for the Examination of Appointments as detailed in the Government Companies Law.

Accounting and Financial Expertise

In accordance with Section 92 (a) (12) of the Companies Law, the Board of Directors of the Company has determined, in its meeting of May 27, 2015, that the minimum number of Directors with Accounting and Financial Expertise required by the Company, is 1.

Independent Directors

According to Sections 219 c and 239 of the Government Companies Law, at least two external directors are required to serve in a "debenture company." Members of the Board sign a declaration verifying non-conflict of interests, and also undertake towards the Government Companies Authority, to refrain from conflicts of interest between their activities in the Company and their activities in other spheres.

Board of Directors' Diversity

In 2017, the total number of board members was 8. Board members' diversity is achieved through coordination with the regulatory functions.

	2017	2016	2015
No. Women members of the board	5	5	2
No. Men members of the board	3	5	6
No. Independent directors	4	6	5
No. members representing a minority *	0	1	1
No. members in the sustainability committee	4	2	2

* From the Druze community. Between the start of Y2018 and the publication date of this report, a female director was appointed from the Druze community.

Corporate Governance at IAI

Company Secretary

IAI's Company Secretary is responsible for the ongoing connection and coordination between the Company's Board of Directors and the Company's Management. Inter alia, the Company Secretary is entrusted with the management, coordination, and documentation of Board Meetings, and is also responsible for the reception, training and interfaces between new directors and the Company. The Company Secretary is also responsible for the connections between the Company and the Government Companies Authority as well as for reporting to the Securities Authority.

Board of Directors Activities

In 2017, IAI's Board of Directors held a total of 62 meetings.

	2017	2016	2015
No. of general assembly board meetings	17	16	14
No. of board committee meetings	45	39	57
No. of board sustainability committee meetings*	4	3	3

* Out of the total number of board committees meetings

Environmental Risk management

IThe Company's Board of Directors is committed to a sustainable development and to an organizational culture which fosters corporate responsibility. As part of its commitment to sustainable development and in compliance with the instructions of the Government Companies Authority in this matter, the Company's management holds discussions in relation to the planning and implementation of such matters. In addition, management reports specifically on these items are directed to the Sustainability Committee of the Board of Directors. With respect to environmental risks and the management of such risks, (including statutory regulations related to decision making) see Section 22 of the Fourth Chapter of the Financial Statement of the Company (in Hebrew) for 2017, pages 113-114.

Corporate Risks Management

According to a circular of the Government Companies Authority dated June 11, 2009, a government company is required to establish an organized process for risk management, and to establish control mechanisms. Within this framework, the Board of Directors has a duty to establish risk management policies and to supervise their implementation. The Company has established and implemented such processes and updates these from time to time.

Corporate Governance at IAI

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Management of the Internal Enforcement Plan with respect to the Securities Law

The Company maintains an internal enforcement plan with respect to the Securities Law, in order to respond to possible exposure cases relating to potential breaches of the Securities Laws that could arise in relation to the Company's activities, its business environment, its organizational structure, and relevant legal framework. The Board of Directors has appointed the Company's Chief Accountant as responsible for internal enforcement of these matters for the Company.

The Board of Directors and Approval of the Company's Financial Statements

The Company's Board of Directors is entrusted with the overall control of the Company and approval of its financial statements. The Company established a Board Committee for the Examination of Financial Statements and Investments (hereinafter - "the committee"), in accordance with the Companies Regulations (instructions and conditions for the process of approval of the financial statements) – 2010 ("Financial Statements Approval Regulations"). The Committee discusses the Company's financial statements alongside developments in the company's business activities, and makes appropriate recommendations to the Board of Directors, relating to such financial statements. The Board of Directors discusses the committee's recommendations and ultimately chooses to accept and approve the Company's financial statements, or to seek further information, commentary, and/or revisions prior to providing such approval.

Limitations and Supervision over the Company

With respect to the restrictions and supervision over the Company (including legal regulations regarding decision making, etc.), see Section 23 of the Fourth Chapter of the Financial Statement of the Company (in Hebrew) for 2017, pages 115-117.

IAI's subsidiaries

Subsidiaries' financial statements and structure are reported to the Board of Directors.

IAI's Internal Audit

IAI's internal auditor manages the internal audit unit in accordance with the Israeli law. The internal auditor reports to the Board of Directors and its audit committee.

Senior management rewarding policy

IAI operates by a set policy for Senior Management rewarding, based on:
>> Long-term company growth policy
>> Benefits based on the company's risk management policy
>> The company's size and nature
>> Components relating to the specific function and his/her contribution to meeting the company's long-term goals.

Corporate Governance at IAI

103-1 | 103-2 | 103-3 | 307-1 | Limited Assurance

Material Topic

Compliance

IAI's sustainability program is founded on our uncompromising commitment to comply with all the laws and regulations applicable to our operations and businesses. With a multitude of processes, transactions and company activities, we are required to adhere to numerous legal requirements on a daily basis. Specifically for our environmental, occupational health and safety requirements, we have installed an online system in order to ensure effective controls and compliance with their most up-to-date versions. The online system allows us to receive timely updates of current and future legal requirements, so that we can implement readiness plans in advance. In the event that non-compliances are identified, senior management is informed and corrective actions are taken. Furthermore, and whenever appropriate, the event or issue is reported to our Board of Directors and/or external auditors and, if the relevant criteria are met, is disclosed to the public.

To the best of our knowledge, and up until the date of issuance of this report, no sanctions, fines, or letters of violations were submitted to IAI regarding our 2017 environmental performance.

Material Topic

Sustainable Risk Management

In 2013, IAI underwent an extensive process of cross-organizational Enterprise Risk Management Assessment. The process was based on the Committee of Sponsoring Organizations of the Treadway Commission (COSO) enterprise methodology, taking into consideration the company's vision, strategic objectives and values. The process was in line with the Government Companies Authority instructions and IAI's senior management was deeply involved in the process, which was directly overseen by the Board of Directors. 17 different risk classes, including governance and environmental risks, were prioritized. The management has appointed the VP of Planning and Control to serve as Chief Risk Officer, directly reporting to IAI's CEO and Board of Directors' Risk Committee on risk identification and mitigation plans. Furthermore, IAI's annual internal auditing plans take into account prioritized risks throughout the company.

As an outcome, an in-depth assessment was conducted on governance and environmental risks, aiming to link the company's risk management to more efficient mechanisms of planning, operating, measuring, and reporting in a sustainable way. In addition, the process took into consideration the changing regulatory environment and the Israeli Sustainable Development Guide to Governmental Companies - 2013. The assessment report continues to serve as the basis for the annual work plans of the Sustainability and Environment Organization, closely monitored by the Senior Management Sustainability Steering Committee. A specific mechanism is also set under IAI's project management methodology, to ensure the identification and mitigation of all risks, including risks to the environment. Direct risk management responsibility in our projects rests with project managers, and during a project evaluation phase, a project risk manager is assigned to map, track, and maintain a risk list, including their classification (based on severity and probability). Designated teams are established to mitigate and control the identified risks, and an external official from the company is assigned to monitor the outcomes of those efforts. Risk identification and classifications continue throughout the entire project milestones, and recorded in an online tool available on the company's INTRANET.

In 2017, a new Enterprise Risk Management Assessment was initiated, to be finalized in 2018.

Corporate Governance at IAI

Precautionary Approach in Action

The Sustainability and Environment Organization continuously tracks and analyzes sustainability risks to IAI's operations, leading mitigation efforts with group and division managers, and seeks to leverage environmental, social, and economic opportunities as part of our sustainability policy. Major sustainability risks are reported to the Senior Management Sustainability Steering Committee, and in relevant cases, to the Board of Directors Sustainability Committee, to ensure an appropriate response.

Crisis Management and Business Continuity

Material Topic

IAI has embedded clear procedures and work instructions to ensure continuous operations and projects in cases of potential, unexpected and severe incident occurrences, such as earthquakes, cyber or terror attacks or major fires. By defining and establishing effective response processes during an incident, utilizing trained emergency response teams from within the company, and employing rehabilitation strategies and crisis management methodologies when necessary, IAI is ensuring the survival and continuous functioning of its core critical processes in: human resources, supply chain, facilities, organizational key members, materials management, technology development, communications, information and Records and Security.
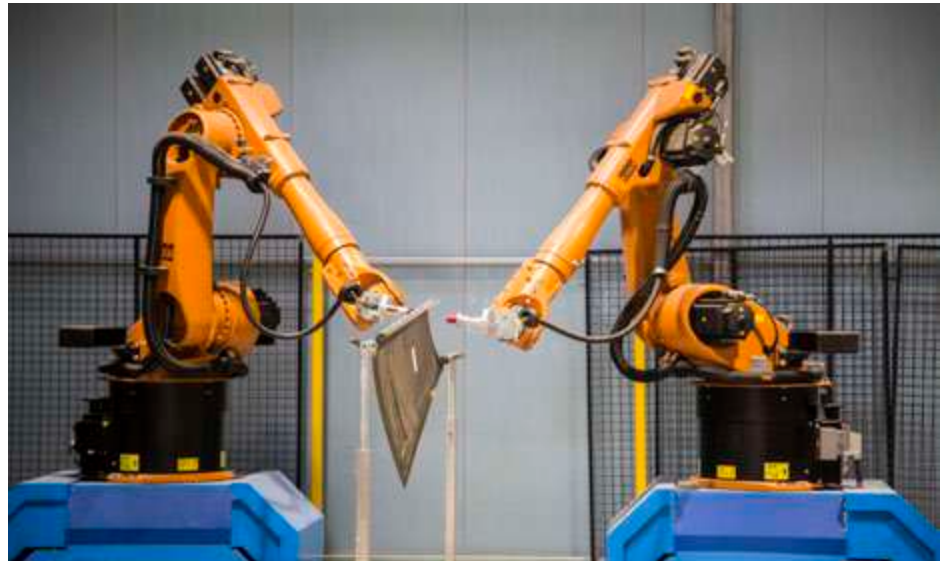
Ethics

IAI's Code of Conduct

IAI's Code of Ethics is the system of rules, principles, and procedures by which we define appropriate and acceptable behavior. The Code dictates a high standard of conduct by measures of integrity, fairness, and morality. IAI is requiring its managers and employees, through training, company procedures, work instructions, and supervision, to comply with the code on a daily basis. The code of ethics, which was last reviewed in 2016, is available on our website, and its training materials are available through the company's INTRANET. A refresher course is conducted once every two years, and is mandatory for all employees. It reviews various topics from the code, such as conflicts of interests, illegal benefits, employees' maltreatment, sexual harassment, environmental responsibility, etc. IAI is encouraging its employees to voice their ethical concerns through designated Human Resources personnel or direct managers, particularly in cases that are not defined and clear-cut by law or the Code of Ethics.

In 2017, 11% of our employees have completed the web-based Code of Ethics training, as part of the 2017-2018 cycle of refreshers. It is therefore expected that all employees will complete their training cycle by the end of 2018.

The Code covers seven main topics:

1. Marketing and Sales
2. Quality, Sustainability, Environment, Safety and occupational Health
3. Employment and working relationships
4. Customers, partners, suppliers and owners
5. Conflict of Interest and illegal benefits
6. Protection of assets, privacy, information security and confidentiality
7. OECD compliance program

Our code of conduct is available here:
http://www.iai.co.il/Sip_Storage//FILES/4/42304.pdf

The 2017 non-ethical claims case

On March 15th 2017, the Company learned of an investigation launched by the Israeli Police against the Company. On March 16th 2017, the Company was notified by police officials that a police investigation has been initiated and that several Company employees had been arrested. The Company also learned that a director in the Company at that time had also been arrested for interrogation and later released to house arrest. In May 2017, The Company received official information from the Israeli Police on the suspicions regarding several employees in the Company (including a senior officer) which many consist of alleged illegal acts (as applicable) committed in the context of certain engagements with suppliers and alleged extortion under threat of political manipulation. After examination of the above information, the Company estimates that the investigation will not have a material impact on IAI's operations or business. The company is fully cooperating with the Israeli Police, and is acting as per its instructions.

Substantial resources continue to be invested, both internally and externally, to address any improper practices and conduct in accordance with the "zero tolerance" policy. IAI's dedicated and professional employees will continue to strive for full compliance with the appropriate laws and ethics standards.

Ethics

Material Topic

Internal compliance and anti-corruption

IAI manages its business activities in compliance with the laws of the State of Israel and of other countries in which it operates, and is committed to running its business with integrity, fairness, reliability, and professionalism. IAI has integrated and implemented a compliance program to prevent bribery of foreign public employees and updates such compliance program from time to time. As part of the program a Company Compliance Officer was appointed, approved by the Board of Directors.

In 2017, approximately 800 employees were trained via e-learning and 500 more employees were trained in frontal classes on anti-corruption. All participants were managers with any relationship to foreign customers, such as marketing, contracts, financial and more.

In a 2015 report on DEFENCE COMPANIES ANTI-CORRUPTION INDEX, published by Transparency International UK every three years, IAI was noted as one of three companies which improved significantly compared with 2012 (from band F to band C). Moreover, we were ranked among the five companies in our geographical region as top scorers in public information on:

>> Leadership, governance and organization

>> Risk management

>> Company policies and codes

>> Anti-corruption and bribery prevention Training

Major strategic Sustainability Memberships and Alliances
102-12 | 102-13

IAI regularly participates in and contributes to various associations, forums, and alliances to broaden knowledge-sharing and identify collaborative opportunities in areas associated with sustainability, as well as with our professional expertise.

In Israel

As the largest governmental employer in Israel, we take part, and in some cases, lead important efforts to advance both expert-environmental and social-based initiatives and projects. Among our partners are: The Manufacturers Association of Israel (professional and environmental groups); the Standards institution of Israel; the Israeli users' association of advanced technologies in High-tech integrated systems (ILTAM; various professional and environmental groups); the Israeli Institute of Energy and Environment; MA'ALA association for corporate social responsibility, etc.

International Aerospace Environmental Group (IAEG)

The IAEG is a Trade association formed by major international aerospace companies, focusing on its members' preparedness to future laws and regulations regarding health and the environment in the global A&D sector (civil and defense). The association is advancing mutual efforts in transforming the A&D value chain to becoming more sustainable, to reduce potential risks and make aerospace products more environmentally-friendly. As sole Israeli participants in this association, IAI is involved in various working groups, such as Chemicals disclosure, Harmonized supplier questionnaire, and Green House Gases (GHG) sector guidelines.

International Transparency (IT) and Society of Corporate Compliance and Ethics

As an expression of our intent to practice good ethics and demonstrate more transparency, IAI chose to become a member in two international associations that assist organizational compliance officers in maintaining and upping the company's performance on these critical issues.

# PART 4

Environmental Management

Environmental Management at IAI

Material Topic

Environmental management and practices at IAI were first initiated in the mid 1980's, mainly toward increased employees' safety and improved handling of hazardous materials and waste. In 1994, a Steering Committee for Environmental Management was established, and initiated a thorough assessment of the company's operations and their impact on the environment. Following this meticulous review, the first environmental management policy was defined and the company began to measure and set goals for continual improvements. Today, with all of our manufacturing divisions certified to ISO 14001 standard as a basic practice, IAI is continually monitoring its environmental impact and strives for effective energy, air, water, sewage, and waste management, while cooperating in confronting the challenges faced locally and globally by the A&D industry.
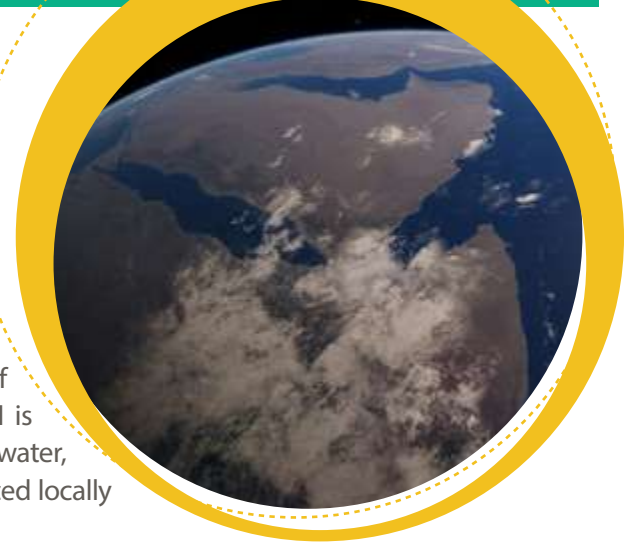
Environmental Challenges in Aerospace and Defense industry

Aviation allows human beings to fulfill one of the basic human rights as defined by the UN - the freedom of movement and accessibility. These are required so other rights can be met - establishing relationships, fair trade, competitiveness, equal opportunities, safety, etc. These social benefits need to be guarded and enhanced, when developing new solutions.

Current aircraft technologies generate environmental costs by relying exclusively on fossil fuels, a non-renewable energy source with a geopolitical sensitivity and significant emissions of air pollutants and greenhouse gases. The manufacturing, operation, maintenance, and scrapping of aircraft present considerable environmental footprints. In addition, global material scarcity is a growing concern for continuous manufacturing, alongside tighter regulations, causing numerous raw materials to be phased-out by the industry.

IAI continues to join forces with industry colleagues in improving the overall A&D sector sustainability performance. From developing new solutions for aircraft as part of the European Union Horizon 2020 program, to participating in setting the industry guidelines and solutions developed by IAEG (see page 64).

IAI Spotlight

VENμS, the environmental satellite

102-15 | 201-2
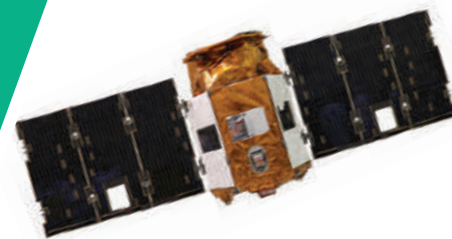
MBT Division, under the Systems, Missiles and Space Group, developed and successfully assesmbled and launched the smallest satellite of its kind in the world, weighing only 265 kg, in collaboration with the Israeli Space Agency (ISA) and the French space agency CNES.

VENμS (Vegetation and Environment Monitoring on a New micro (μ) Satellite) scientific mission focuses on the monitoring of land vegetation and inland and coastal waters, using a 12 spectral bands (VIS-NIR) camera with five meter resolution and sensitivity beyond visible light frequencies. The satellite takes images once in every two days at the same shooting angle, covering approximately 110 areas of agriculture, forestry, water bodies and ecological systems in Israel and around the world. The technology allows detecting rapid changes occurring in the monitored areas and identifying potentially evolving threats, such as disease, drought, and pollution.

Images of Tiberias Lake (Left) and the City of Eilat (Right), taken by VENμS

Energy

Material Topic

Energy Management

All manufacturing industries consume energy for operation and growth. Globally, countries are looking for ways to increase the renewable energy share in their total energy consumption, as opposed to consumption of the dwindling quantities of non-renewable energy sources, responsible for air pollution and climate change. We feel that acting on energy consumption for both residential and industrial activities on our sites, and raising efficiency rates wherever possible are urgent commitments, and we strive to get all our infrastructures (electricity, fuels, and natural gas) to operate in optimal conditions, maximum economic efficiency, and eco-friendliness.

Each IAI division and some of the supporting units employ an Energy Officer, responsible for energy management, including data collection and reporting. Division managers conduct programs of energy efficiency, including replacement of inefficient HVAC, lighting and manufacturing processes. The divisions also train Energy Trusties for monitoring and following up on designated facilities, promoting employees' awareness and ensuring preventive maintenance, as well as reporting on the facility's performance to the division energy officer.

In 2017, over 200 hours of training on energy supply and consumption were delivered to key employees, including division general managers, energy officers, and energy trustees. Each division manager was given a concise kit for operational guidelines on energy consumption, allowing them to address all levels in their respective units, and establish an annual work plan.

To date, 3 of our groups and divisions received their certification of ISO 50001 standard for energy management in operations. Additional Divisions are in the pipeline for certification in coming years.

Energy

Material Topic

Electricity consumption

The total electricity consumed in 2017 was 756,531 GJ. In 2017, IAI did not sell any energy (electricity, cooling/heating or steam).

On May 2014, IAI has transferred all its electricity consumption to a private supplier, 100% on based on Natural gas.

As of 2007, IAI established a continuous working plan to implement cross-organizational efficiency and saving measures. Since 2007, 24% savings were achieved in relation to the business as usual scenario, equaling to a total of 500 GWh. The savings were achieved alongside a rise in total electricity consumption in 2017, due to new buildings being populated and general increase in production.
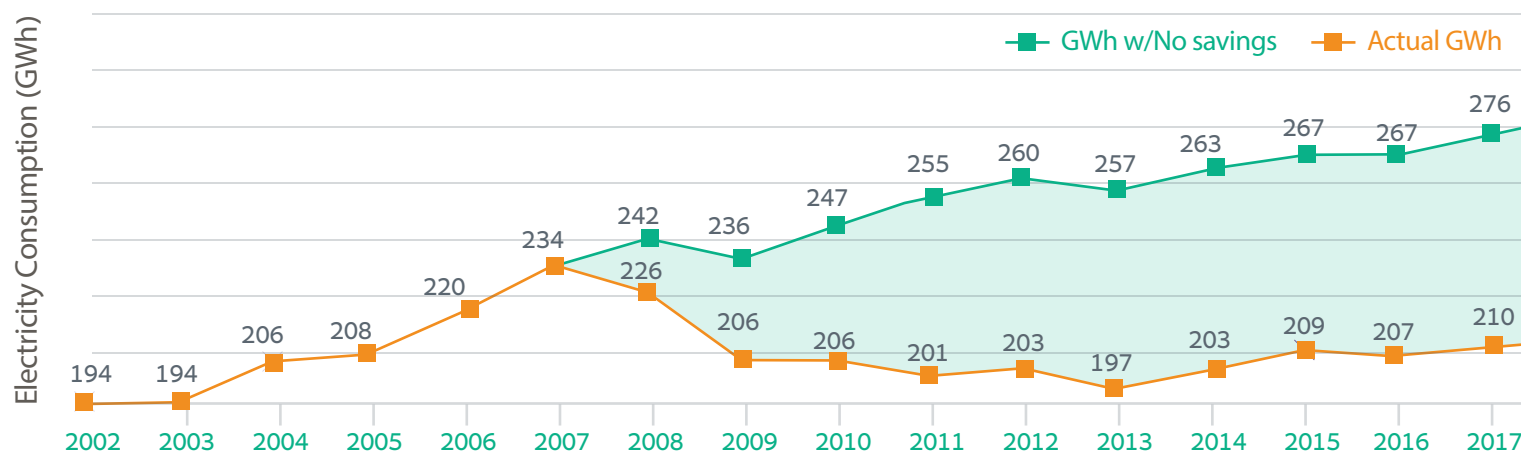
Overall Electricity Consumption and Savings 2002-2017, in GWh

Energy

Electricity Consumption* in GJ

* Source used for data unit conversions: The 2006 Guide of the Intergovernmental Panel on Climate Change (IPCC).

Energy

No renewable energy sources were utilized by IAI in 2017; however IAI has started a feasibility study toward potential implementation of solar panels in our sites, as part of our climate change strategy and our energy savings program.

Fuel Consumption in Industrial Uses

The total fuels consumed in 2017 for industrial uses were 84,134,025 MJ, an 13% decrease from 2016. In 2017, a notable increase of 41% was noted in liquefied petroleum gas (LPG) consumption compared to 2016, accompanied by a decrease in industrial diesel fuel. This was due to increases in operational rates relying on LPG.

Industrial Fuel Consumption* in MJ

Energy
302-1 | 302-4 | Limited Assurance
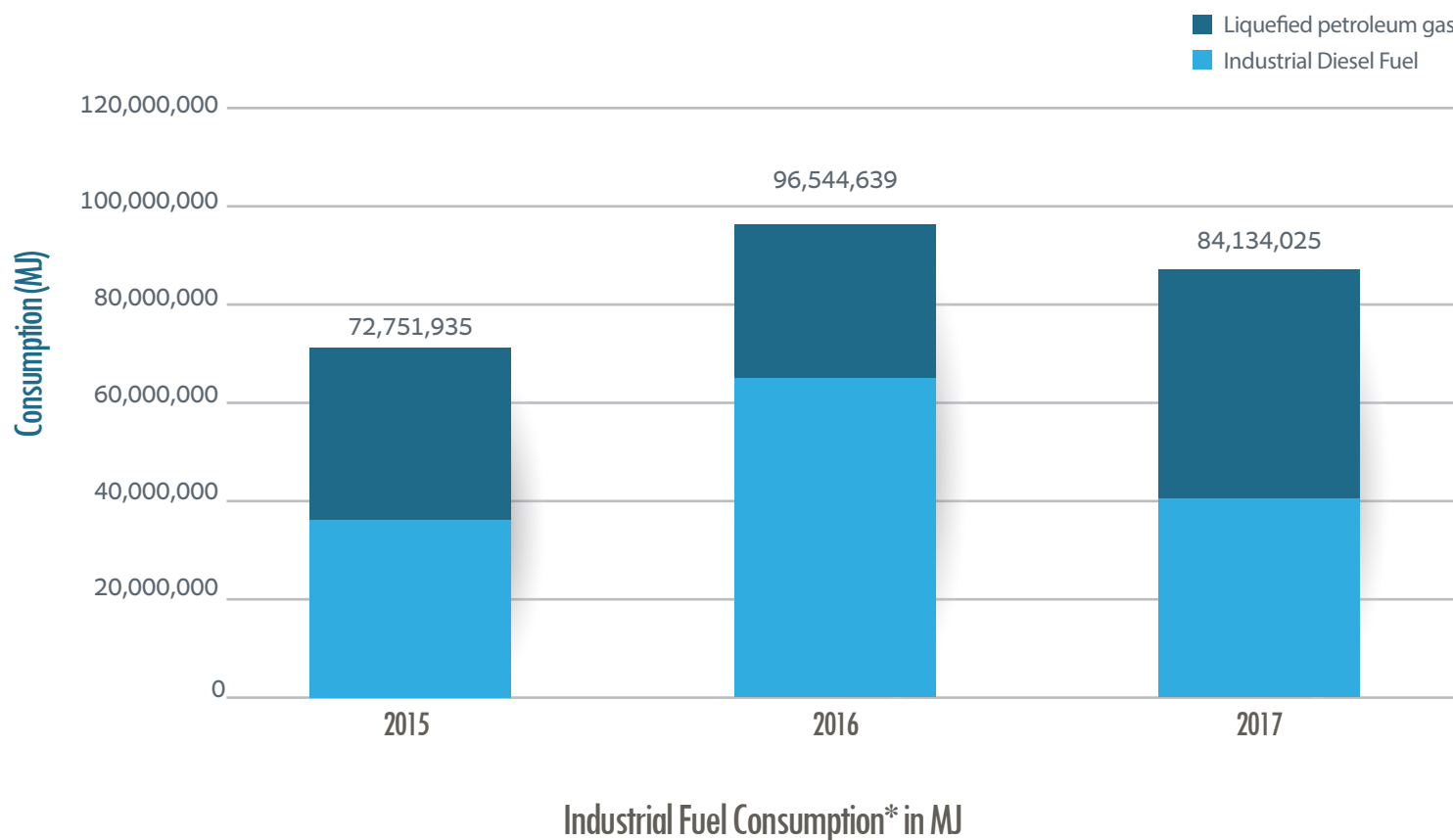
Fuel Consumption in Transportation

IAI operates a leased car fleet for its employees, as well as a fleet for short travels between its sites. Total travel in 2017 was 94,680,876 kilometers; a decrease of 19% compared to 2015. This indicator is estimated based on total automotive fuel consumption for transportation (see table below) and an average of 12L/Km consumption rate by vehicles.

Jet fuel is divided into a minor consumption by the Business Jets division, under the Commercial Aircraft Group, and the main consumption of the BEDEK Aviation Group, for the purpose of returning MRO aircraft to customers overseas. In 2017, our jet fuel consumption increased by 3.5%, due to higher rates of operations.

In 2017, an additional increase in our Diesel fuel consumption for transportation was noted compared to 2016, and a decrease in gasoline consumption. We expect these rates to drop in 2019-2020, as a new policy set in 2017, coming into effect in 2018, limits the offering of Diesel fueled cars to our employees, while increasing the number of hybrid vehicles uptake (see table below).

Table: Fuel consumption for transportation, by type

Fuel Type		2017 Consumption (Liters)	2016 Consumption (Liters)	2015 Consumption (Liters)
Automotive	Diesel Fuel (50)Aviation	801,223	559,984	183,772
	Gasoline (95)	7,088,850	8,408,135	9,557,590
Aviation	Jet Fuel	3,604,560	3,485,079	3,417,000
Total		11,494,633	12,453,197	13,158,362

* Source used for data unit conversions: The 2006 Guide of the Intergovernmental Panel on Climate Change (IPCC).

Table: Number of Hybrid cars in IAI's fleet

2017	2016	2015
149	31	0

Green House Gases (GHGs) and Climate Change
305-1 | 305-2 | 305-4 | Limited Assurance

Material Topic

The year 2017 continued to demonstrate new records for global temperatures, being the second-hottest year ever, according to NASA. In 2017, IAI initiated a carbon control cross-organizational program, including:

>> Reporting in the Carbon Disclosure Project (CDP)-climate framework, with 2017 being our first reporting year.

>> Joining the voluntary GHG reporting scheme led by the Israeli Ministry of Environmental Protection, with 2017 being our first reporting year

>> Developing specific goals for GHG reduction as part of our 2023 sustainability goals (see page 23) Supporting reductions of GHG emissions in aerospace products, through our participation in the Clean Sky 2 program (under the EU Horizon 2020 program)

>> Supporting climate change mitigation in the A&D supply chain through our IAEG membership

Operationally, our main efforts focus on effective energy utilization and greener company travel options, while exploring potential solutions in renewable energy. IAI's GHG inventory is complex, including all our operational sites and subsidiaries in Israel.

Table: IAI's GHG emissions

Source	2017 CO_2 metric ton equivalent emissions	2016 CO_2 metric ton equivalent emissions	2015 CO_2 metric ton equivalent emissions	Trends in emissions between 2016-2017
Scope 1: Direct emissions				
Stationary fuel sources (Industrial fuels)	**6,037**	7,375	4,812	
Mobile fuel sources (transportation fuels)	**30,121**	32,166	33,600	
Total scope 1	**36,158**	39,541	38,412	⬇
Scope 2: Indirect emissions				
Electricity consumption	**92,045**	88,265	85,952	
Total scope 2	**92,045**	88,265	85,952	⬆
Total emissions (scopes 1 & 2)	**128,203**	127,806	124,364	⬆

GHG Intensity

Our GHG intensity is calculated **per total built area,** 874,744 square meters in 2017:

GHG intensity	2017	2016	2015
Scope 1	**0.041**	0.046	0.047
Scope 2	**0.105**	0.102	0.105

The sources included in the calculations were fuels for industrial consumption and transportation and our electricity consumption, based on 100% natural gas use by the electricity supplier. The electricity savings in 2017 (scope 2) were gained alongside a rise in consumption, due to new buildings being populated and a general increase in production operations.
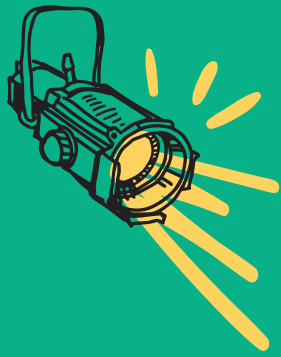
IAI Spotlight

The SkyTran project

102-15 | 201-2

LAHAV Division, under the Military Aircraft Group, in collaboration with SkyTran Company, are developing personal rapid transport (PRT) system for public transportation, based on magnetic levitation technology originating from NASA. The system is based on small autonomous capsules that travel over a monorail with a very low physical footprint within the urban setting, a feature that allows to deploy the network above city roads. Each capsule contains 2-4 seats, that move efficiently through the monorail network, guided by a central command and control system. Thus, thousands of individuals are able to travel every hour.

In the last few years, IAI had built a full scale technology demonstrator, which runs over 200 meters. The demonstrator serves to test the system's engineering design, electricity consumption, electromagnetic performance, and safety. This green transportation system offers an electrically-based and silent travel, thus solving both urban noise, air pollution and climate change implications.

Waste Management

306-2 | 306-4

Raw materials are exhausted quickly on a global scale. This situation calls for better management of waste – both economically and environmentally – and employing systems that go beyond mere pollution prevention actions. IAI is focusing its efforts in continually looking for more recycling and reuse opportunities, while implementing a smarter raw material use.

Compared with 2016, our recycling/reuse rate for hazardous waste dropped from 59% to 54%, while our recycling/reuse rate for non-hazardous waste slightly dropped from 58% to 56%. However, a significant decrease occurred in both our hazardous and non-hazardous wastes overall weight, compared with 2016.

Hazardous Waste

In 2017, total of 1,765 metric tons of hazardous waste were evacuated from IAI's sites, a 30% decrease compared to 2016, and all waste designated for reuse or recycling was treated based on the waste contractor alternatives. All exported hazardous waste was designated for Waste-to-Energy via a hazardous waste exporter, who is compliant and authorized by the Israeli Ministry of Environmental Protection.

Hazardous Waste, in metric tons

Waste Management

Non-hazardous Waste

In 2017, a total 6,336 metric tons of Non-hazardous waste were evacuated from IAI's sites, a 37% decrease compared to 2016, of which 56% wer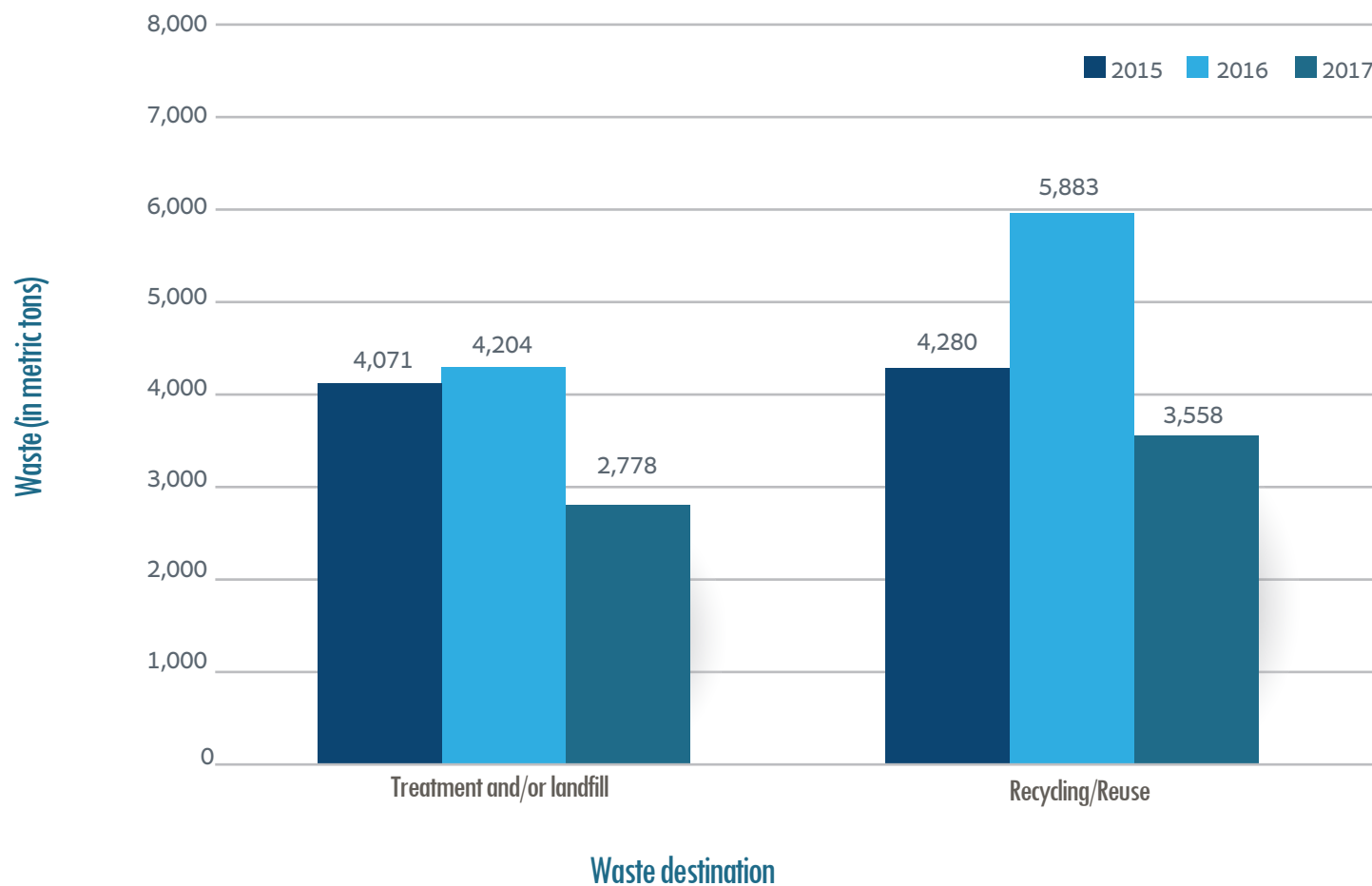e sent for recycling and the rest for landfill. All waste recycling was done based on the waste contractor alternatives.

Non-Hazardous Waste, in metric tons

Water and Effluents

303-1 | 306-1 | Limited Assurance

Material Topic

Israel is situated in a geographical area that suffers from water shortage, leading to a globally-acknowledged leadership in water technologies. Although the water economy in the region continues to stabilize with large investments in national infrastructure and efficient water recovery of over 75% effluent recovery for agriculture, IAI regards water consumption in its operations as a significant resource by taking active steps to make it more efficient and continues to promote desalination technology development.

Water Consumption and Efficiency

Total fresh water consumed in 2017 was 681,033 cubic meters, including all water sources in use at the following sites: Ben Gurion Airport campus, ELTA systems Ltd., MLM, MBT, TMM, and RAMTA. Previous reports covered Ben Gurion Airport campus consumption only (where the majority of IAI's water is consumed).

All water consumption data are based on external consumption monitoring and billing information.

Effluents Treatment

All of IAI's effluents are managed based on their level and type of contaminates. In manufacturing process with high concentration of contaminates compared with regulatory levels, the effluents are diverted into specific in-house effluent pre-treatment facilities, prior to their final discharge from IAI.

Total Effluents discharged in 2017 was 209,249 cubic meters at Ben Gurion Airport campus only (where the majority of IAI's industrial wastewater is emitted). This is an increase of 3% compared to 2016, originating from higher production rates. As for the other sites, the quantities of industrial effluents in extremely low, as most of the water consumed is directed to drinking and sanitary uses.

All effluent discharge data are based on external consumption monitoring and billing information.

Soil Surveys

Based on the requirement of the Government Unit for Licensing Security Enterprises, in 2011, IAI conducted historic surveys (Phase I), which included collecting relevant information regarding potential areas of environmental concern in the company's real estate properties in all its sites from historical use. As of this report release date, a detailed multi-year plan for additional surveys was delivered and authorized by the relevant authorities for additional site investigations, which are prioritized based on the extent of operations in each site. A Phase II Environmental Site Assessment was conducted in the Production Technologies Division, from the Commercial Aircraft Group in 2016. The site assessment included soil, soil vapor, and groundwater sampling. Volatile chlorinated organic compounds were measured at the former location of a tetrachloroethylene (PCE) degreaser at the site. The Israeli Water Authority required additional groundwater investigations in this area to delineate the impact on the site.

Air Quality

305-7

Air quality is directly linked to the population's health, having a measurable impact on the economy and the environment. The major contributors having a direct influence on air quality are the transportation, industry, and agriculture sectors. IAI is constantly searching for new ways to reduce hazardous materials use in its manufacturing lines, as well as implementing systems to reduce emissions from its operations and transportation sources.

IAI factilities' compliance with the Israeli Clean Air Law - 2008

The Israeli Clean Air Law, which came into effect January 2011, was designed to dramatically impact all sources affecting air quality in Israel through regulatory mechanisms. Following an extensive evaluation process done in all our facilities, two of our facilities were found to fall under the Israeli Clean Air Law - 2008 regulations criteria. Those facilities underwent a series of processes to meet all legal requirements, and their 2016 performance is according to stack monitoring and calculation methodologies defined in the Israeli Pollutant Release and Transfer Register - 2012. Note that Persistent Organic Pollutants (POP) are not present in IAI's operations.
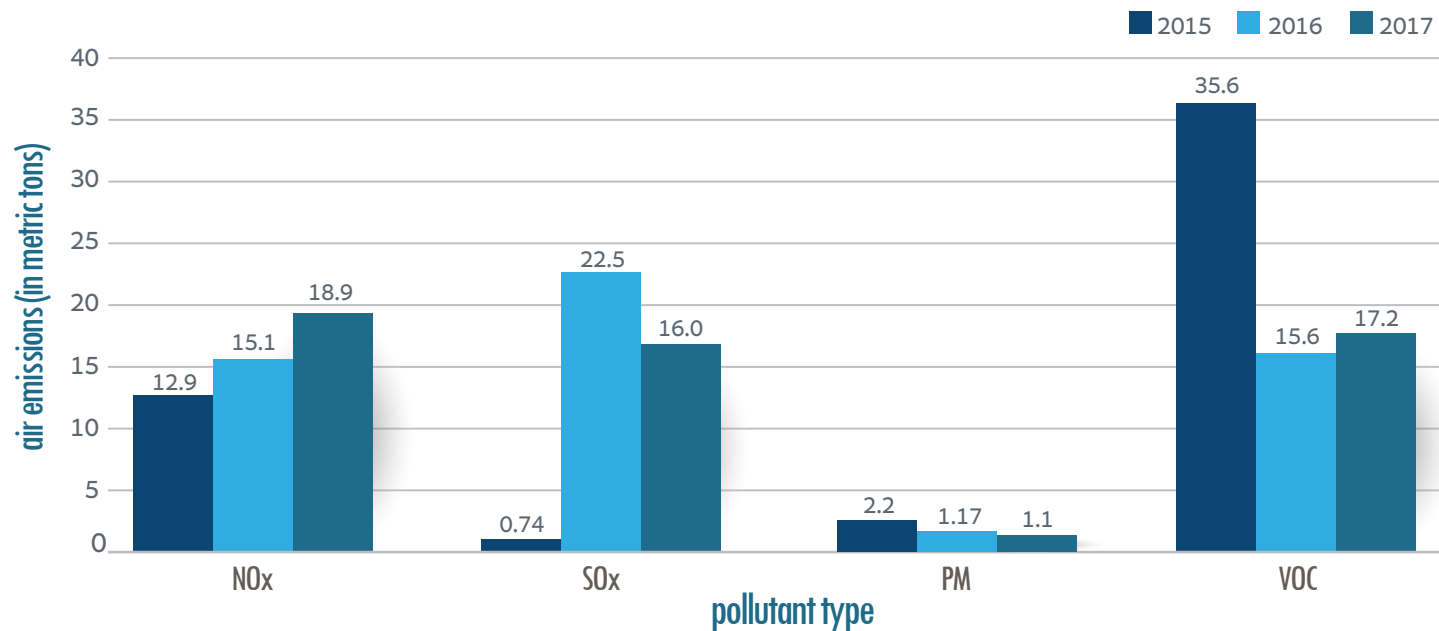
2015-2017 Air Emissions comparison, in metric tons

The continual rise in 2017 NOx emissions is attributed to a significant workload undertaken by one of the facilities compared with past years.

GRI Content Index

GRI Content Index

Content Index
Israel Aerospace Industries Ltd.

Aug 2018 | Service

GRI standard	Disclosure		Page	Omission
GRI 101: **Foundation 2016**				
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	102-8	Information on employees and other workers	44	
	102-9	Supply chain	33-35	
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GRI standard	Disclosure		Page	Omission
General Disclosures: Strategy				
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General Disclosures: Ethics and Integrity				
GRI 102: General disclosures 2016	102-16	Values, principles, standards, and norms of behavior	62	
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GRI 102: General disclosures 2016	102-18	Governance structure	56-59	
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	102-34	Nature and total number of critical concerns	61	

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GRI standard	Disclosure		Page	Omission
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Corporate Governance: Anti-Corruption and Bribery Prevention Practices				
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GRI 103: Management Approach 2016	103-1	Explanation of the material topic and its boundaries	61,67	
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GRI 201: Economic performance 2016	201-1	Direct economic value generated and distributed	30	
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GRI 203: Indirect Economic impacts 2016	203-2	Significant indirect economic impacts	36	
GRI 204: Procurement practices 2016	204-1	Proportion of spending on local suppliers	36	
Material Topics: **Social: HR Management**		Explanation of the material topic and its boundaries		
GRI 103: Management Approach 2016	103-1 103-2 103-3	The management approach and its components Evaluation of the management approach	40-42 40-42 40-42	
GRI 201: Economic performance 2016	201-3	Defined benefit plan obligations and other retirement plans	47-48	
GRI 202: Market presence 2016	202-2	Proportion of senior management hired from the local community	45	
GRI 401: Employment 2016 GRI 404: Training and education 2016	401-1 404-1	New employee hires and employee turnover Average hours of training per year per employee	48 46-48	
	404-2	Programs for upgrading employee skills and transition assistance programs	46-48	
GRI 405: Diversity and equal opportunity 2016	405-1	Diversity of governance bodies and employees	44-45	

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Material Topics: **Social: Employment Diversity**				
GRI 103: Management Approach 2016	103-1	Explanation of the material topic and its boundaries	40-42	
	103-2	The management approach and its components	40-42	
	103-3	Evaluation of the management approach	40-42	
GRI 405: Diversity and equal opportunity 2016	405-1	Diversity of governance bodies and employees	44-45	Currently unavailable - the composition of our governance entities based on age. to be reported on our 2018 sustainability report.
Material Topics: **Social: Technological Education**				
GRI 103: Management Approach 2016	103-1	Explanation of the material topic and its boundaries	40-42	
	103-2	The management approach and its components	40-42	
	103-3	Evaluation of the management approach	40-42	
GRI 413: Local communities 2016	413-1	Operations with local community engagement, impact assessments, and development programs	53	
Material Topics: **Social: Occupational Health and Safety**				
GRI 103: Management Approach 2016	103-1	Explanation of the material topic and its boundaries	49-50	
	103-2	The management approach and its components	49-50	
	103-3	Evaluation of the management approach	49-50	
GRI 403: Occupational health and safety 2016	403-1	Workers' representation in formal joint management–worker health and safety committees	50	Currently unavailable - occupational health and safety indicators based on gender. The data will be collected in 2017-2018 and expected to be reported on our 2018 sustainability report. Currently unavailable - Supply chain occupational health and safety indicators. The data will be fully collected in 2017-2018 and expected to be reported on our 2018 sustainability report.
	403-2	Types of injury and rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities	50-52	
	403-4	Health and safety topics covered in formal agreements with trade unions	49	
Material Topics: **Social: Employees Organization**				
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	305-4	GHG emissions intensity	74	
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	103-3	Evaluation of the management approach	67	
GRI 201: Economic performance 2016	201-2	Financial implications and other risks and opportunities due to climate change	67,68,75	
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GRI 103: Management Approach 2016	103-1	Explanation of the material topic and its boundaries	67	
	103-2	The management approach and its components	67	
	103-3	Evaluation of the management approach	67	
GRI 306: Effluents and Waste 2016	306-1	Water discharge by quality and destination	78	
	306-2	Waste by type and disposal method	76-77	
	306-4	Transport of hazardous waste	76-77	

Report profile

2017 is IAI's third reporting year; our last reporting year was 2016. No restatements are noted from our 2016 report. No significant changes in operations, size, or sites were noted during 2017.

This report presents the Israel Aerospace Industries Ltd. performance on corporate responsibility and ethics, as well as on social, economic, and environmental matters. Parts of the report contents were audited for limited assurance by BDO (see pages 6-7) and professional consultation on the report was provided by KPMG Somekh Chaikin.

Reporting Period

All information contained in this report is relevant as of December 31, 2017. In some cases, earlier years were considered for the sake of comparison, trend analysis, and future goal-setting. In other cases, reporting also relates to events occuring after the end of the reporting year and until this report publication date. When such cases appear in the report, this fact was noted adjacent to the data.

Reporting Cycle

This is IAI's third sustainability report. Our company shall continue to publish these reports on an annual basis and in accordance with the latest Global Reporting Initiative (GRI) Standards, in order to keep our stakeholders updated on our performance.

Reporting 'in accordance' with the GRI Standards: Core option

This report has been prepared in accordance with the GRI Standards: Core option. This level of reporting is in line with the company's resources, requirements from its stakeholders and the primacy of the process. These reporting standards can be found at the GRI website www.globalreporting.org. The report was submitted to the GRI Content Index Service, and GRI confirmed the accuracy of the GRI Standards Content Index. The GRI Standards Content Index is located at the end of this report, on page 6-7.

Reporting Scope

IAI has a worldwide business and financial activity, with the majority of its managerial and manufacturing activities taking place in Israel's territory. Relevant financial data specified in this report are in line with IAI's 2017 financial statement and concerns IAI's global activity.

Unless otherwise mentioned, all the data (other than financial) included in this report applies to IAI's activities and operational sites in Israel alone. In some instances, relevant information was given for specific sites only, and this fact was noted in adjacency to the data.

Report profile
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Reporting Process and External Assurance

As part of the reporting process, relevant data collection infrastructure, controls and methods were assessed, in order to build a sustainable reporting framework that will serve the company in assembling sustainability information in a reliable and effective process in future reporting procedures.

As a governmental company, we see great importance in supplying our stakeholders with accurate and reliable information about the environmental and social impacts of our activity. This report was externally assured for a second consecutive year.

Reporting Language

This report is fully written in English. A key highlights report is available in Hebrew at www.iai.co.il/Sustainability.

Legal Disclaimer

To the best of the company's knowledge, the information contained in this report is accurate as of the date hereof, and it accepts no liability for the accuracy or completeness thereof, nor for any reliance on the information or use made of the information, by any person, and the company is under no obligation or liability to update the information contained herein. In the event of any inconsistency between the information in this report and any information in the company's quarterly and annual financial reports, the latter shall override.

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As an interested stakeholder, we would appreciate receiving any comments, queries or feedback you may have on this report or on our sustainability program in general.

Please direct these to:

Nava Sela

Head of Sustainability and Environment Organization

+972-3-935-6101

nsela@iai.co.il

For Media inquiries, please contact:

Eliana Fishler

Senior VP for Communications and Company Spokeswoman

+972-3-935-8509

efishler@iai.co.il