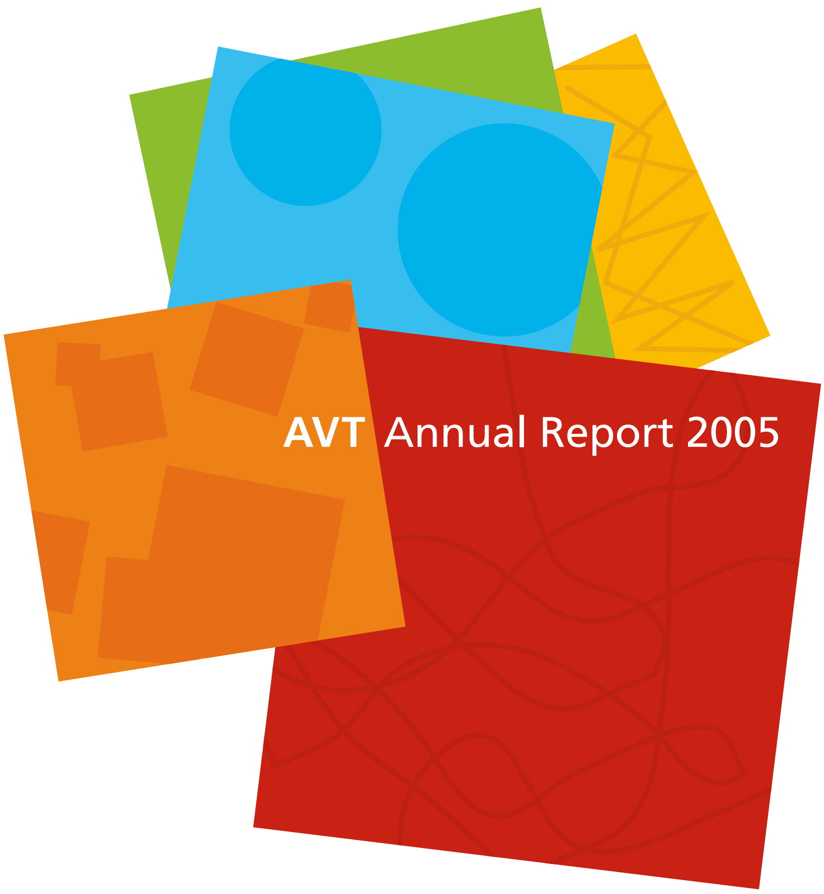

AVT Annual Report 2005

Advanced Vision Technology Ltd.

Financial Highlights

US dollars in thousands (except per share amounts)

Year ended December 31,	2005	2004	2003
Revenues and Income			
Revenues	25,143	21,358	17,264
Gross profit	15,474	13,086	10,168
Gross margin in %	61.54%	61.27%	58.90%
Research and Development expenses, net	3,005	2,698	2,903
Sales and Marketing expenses, net	6,009	6,485	5,086
General and Administration expenses	2,422	1,948	1,704
Restructuring expenses and others	-	-	83
Amortization of deferred stock compensation	39	214	336
Operating profit	3,999	1,741	40
Operating margin in %	15.91%	8.15%	0.23%
Net income	4,201	2,203	494
Cash flows provided by operating activities	4,451	1,335	1,333
Cash flows provided by (used in) investing activities	-1,716	-3,150	12,871
Cash flows provided by (used in) financing activities	130	3	-15,981
Balance sheet as of December 31st			
Cash and Equivalents	7,701	4,836	6,648
Total assets	36,669	31,795	29,120
Total liabilities	7,908	7,404	7,149
Total shareholders' equity	28,761	24,391	21,971
Share			
Net earnings per share in USD	0.96	0.51	0.10
Share price as of December 31st	9.60 Euro	7.10 Euro	4.75 Euro
Employees			
Employees as of December 31st	109	110	103

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AVT is at the point of development where its history is an indicator of its promising future. Organic growth has propelled and maintained its leadership. Technological evolution that consistently adds value has created a global client base that is a paradigm of partnership. A committed, loyal cadre of employees has been the roots of this progress, and customers and shareholders reap the rewards. AVT's strategy of organic growth breeds discipline, responsibility and integrity. When technological creativity, marketing intuition and business acumen are the seeds of organic growth, each harvest represents greater yields.

Dear Shareholders,

I am delighted to report an excellent year for AVT, with revenues and profits continuing to increase. We are successfully expanding our territorial presence, reaching out to relatively virgin markets for our technology in China and Eastern Europe. In 2005, the Americas accounted for 45% of AVT's sales, Europe for 40.3% and the rest of the world for 14.7%.

Overall, with less than 10% of the world's installed base of printing presses in the packaging and labels markets, utilizing machine vision inspection, our potential for growth is exciting and far-reaching.

Facts and Figures

In 2005, revenues grew by 17.7% to $25.1 million, with net profits reaching $4.2 million for the year. Revenues for the fourth quarter were $6.6 million, an increase of 11.8% as compared to the same period in 2004. Order bookings for the fourth quarter were over $7.5 million, an increase of 7% over the same period in the previous year. Our order backlog at year-end was $8.8 million.

Capturing Emerging Markets

In April 2005, we opened a representative office in Shanghai, and appointed William Bai to manage our activities in China. Mr. Bai has extensive marketing experience in the Chinese printing industry, and brings with him a rich network of contacts. Amongst our early customers in China are Cheng Way, Alcan Propack, Shenda Shen Long and Jiaput Chai Wa.

Our participation in several trade shows in the Far East led to concrete results. At trade shows, our own booth is often complemented by demonstrations of our systems on the equipment of our OEM partners. Thus, at Labelexpo Asia in Shanghai, our PrintVision/Helios was demonstrated live on a Gallus press, while our innovative WorkFlow Link, introduced in 2005, was shown on a LeoMat Junior Rewinder, together with PrintVision/Helios 100% inspection. At the same time, customers could see our new PrintFlow Manager on our own stand.

In Far Eastern markets, the need for an "education" process is very apparent. These live demonstrations on print equipment make the saying "seeing is believing" the strongest marketing strategy.

On a different part of the globe, the admission of Central East European countries to the EU, and the globalization of Russian trade, have transformed the graphic arts markets in the region. We are pleased to report that a considerable number of market-leading printers in Eastern Europe and Russia have already opted for our systems, serving as the flag-bearers for others in the industry. Our participation at RusoPak in Moscow, strengthened our visibility in these markets and led to excellent contacts.

Concurrently, we continued to participate in major shows in the US and Europe, where our reputation as the market leader is well-established. At these exhibitions, current and potential customers make a note of visiting our booth, to see our solutions at work, at the displays of our OEM partners, such as Mark Andy, AB Graphic International, Rotoflex and LeoMat.

Adding Value to Platforms

Since its official launch a few years ago, hundreds of packaging printers worldwide have acquired our PrintVision platform. More than 1,200 systems have been sold, complemented by the procurement of over 3,000 add-on modules. Nearly two hundred units of our other core platform, the PrintVision/Helios for label printers, have been sold since it was introduced, and, even more important, have been favored with repeat orders, such as CCL Label's orders for its plants in America and Europe.

The stream of add-on modules for these platforms is a major business generator for AVT. The steady introduction of value-adding modules to extend and perfect the quality assurance and inspection process, are the best proof to our customers that their needs are first and foremost. These modules enable customers to leverage their investment and to realize their drive for excellence.

To achieve this level of involvement and innovation, we invest more than 30% of our human resources in research and development. Effective automatic inspection is achieved through software-based image processing, and customers receive a steady flow of solutions that improve their AVT platforms and increase their value.

Growth Strategy

With the global economy picking up and the identified potential of emerging markets, we will make every effort to continue our growth momentum. We believe we can maintain our leadership position in sales and technology by keeping our ears close to the market, and making leadership, responsiveness and cost-efficiency our mantras. To achieve these goals, we have a clearly defined road map regarding territorial expansion, entry into new market segments and new applications:

We plan to expand further in Southeast Asia, including China, and have a game plan for penetrating the complex, but high potential Japanese market.

We plan to address printers of sheetfed printing in the packaging and labeling markets, and to take firm steps to establish a presence in the large commercial printing market.

We are exploring the applications of promising new technologies in the packaging and labeling markets, such as variable digital printing inspection, and the integration of RFID and printed electronics inspection.

We thank our shareholders, customers and employees for their support and optimism.

Sincerely,

Shlomo Amir
President and Chief Executive Officer

The Management

Shlomo Amir, President and CEO

Mr. Amir joined AVT in 1997. Before joining AVT, Mr. Amir served for two years as vice president of marketing and sales at Nice Systems Ltd., an Israel-based international high-tech company in the area of digital voice logging. Previously, Mr. Amir worked for 12 years at Scitex Corporation, an Israeli high-tech company serving the pre-press industry. In his last nine years with Scitex, he was based in its European subsidiary in Brussels, serving in various marketing, sales and management positions. Mr. Amir holds the degrees of a B.Sc. in Mathematics and Computer Science from Tel Aviv University, Israel, and an MBA from Boston University, Massachusetts, United States.

Noam Noy, V.P. Research and Development

Mr. Noy is one of the founders of AVT, and an expert in visual inspection and machine vision technologies. Previously, he held the position of senior development manager at Orbotech (formerly Orbot), a Nasdaq-listed Israeli technology firm that develops visual inspection systems for the printed circuit board and liquid crystal display industries. Mr. Noy holds a B.Sc. in Electronic Engineering from the Technion, Haifa, Israel.

Zev Morgenstern, Chief Financial Officer

Prior to joining AVT in 1997, Mr. Morgenstern served for three years as finance manager at Precise Software Solutions, an Israeli company that develops database performance tools, and for six years as a senior auditor with a major Israeli accounting firm. Mr. Morgenstern, who is a certified public accountant, holds a B.A. in Accounting and Economics from Bar-Ilan University, Ramat Gan, Israel.

Koby Shtaierman, Executive V.P. Corporate Sales and President, AVT Europe

Prior to joining AVT in 1999, Mr. Shtaierman was vice president of marketing at Technomatix, a multinational company headquartered in Israel that develops computer-aided production engineering software tools for the automotive and aerospace industries as well as heavy industries worldwide. Previously, Mr. Shtaierman served at Scitex for 10 years in various positions, including as R&D project manager and later as director of marketing for Scitex's input systems division. Mr. Shtaierman holds B.Sc. and M.Sc. degrees in Electronics and Computer Engineering from the Technion, Haifa, Israel.

Danny Danziger, V.P. Operations

Prior to joining AVT in 2001, Mr. Danziger served for five years at the Davidoff Group, an Israel-based international company in the area of insurance and medical services. He held various positions, including CEO of Femi Medical Services Ltd., and later CEO of the Davidoff Group. Previously Mr. Danziger served for three years as the CFO of Applicom Software Ltd., an Israeli public company, and for another three years as Chief Operations Officer of Solarom Ltd., a manufacturing company. Mr. Danziger holds a B.A. in Economics and Management from Tel Aviv University, Israel.

Gal Shamri, V.P. Marketing

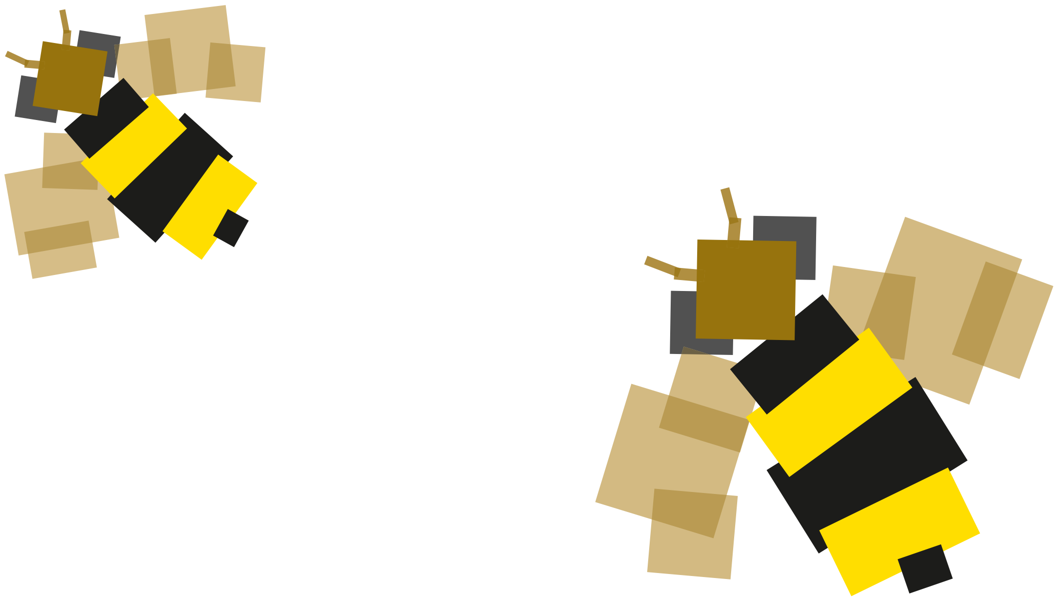
Gal Shamri joined AVT in 1999 and prior to his current position he served as marketing and business development manager and later as corporate marketing manager. Prior to AVT, Mr. Shamri worked at Scitex Corporation for six years in the input division and served in various positions including application specialist and product line manager. Mr. Shamri holds a BA Degree in Economics and Business Management from Haifa University and an MBA degree from Tel Aviv University.

Lance Shumaker, President, AVT Inc.

Mr. Shumaker joined AVT in 1998. Before joining AVT, Mr. Shumaker held various positions in the graphic arts market to include: director of sales for Indigo America, an Israel-based international high-tech company in the field of digital printing, and national accounts manager for Scitex America Corporation, an Israeli high-tech company serving the pre-press industry. Most recently, Mr. Shumaker was the vice president of sales for TeleServices International, a tele-marketing company. Mr. Shumaker holds a marketing degree from the University of Missouri, United States.

It takes timing to harvest opportunity's flavor

Our marketing team is known for its technical expertise and business insight into different markets. From the highly developed, sophisticated environments of the West to emerging, developing regions whose fast-paced economies are accelerating demand for higher standard products, each territory is different. The backbone of our global leadership position continues to be Europe and North America. At the same time, we are vigorously pursuing opportunities in India, China and South America. The latter markets, particularly India and China, are indeed ripe for our technology and business model. Their eyes are turned outward to trade and services for the West, and thus they must meet high expectations for quality, timeliness and cost-effectiveness. Working hand-in-hand with ambitious printers, we help them toast success.



It takes teamwork to produce sweet profits

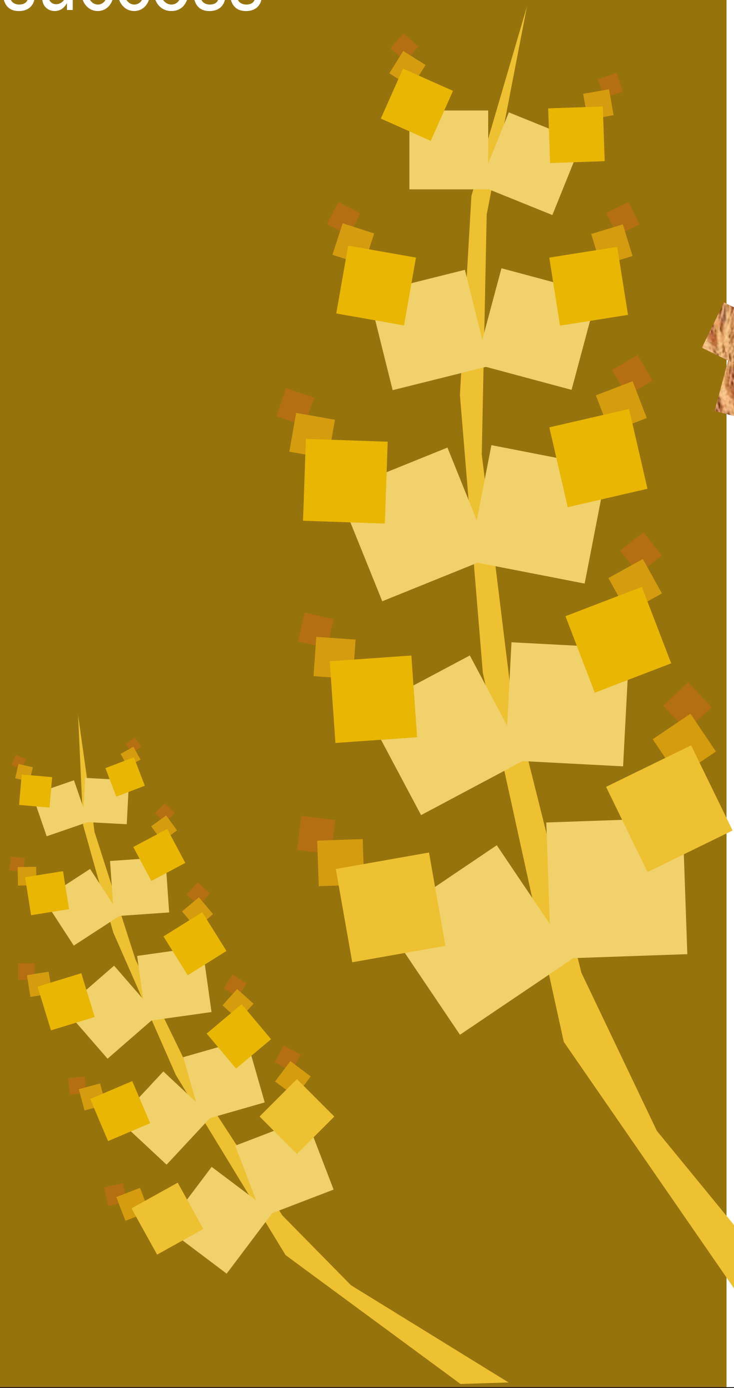
Our R&D,
the spearhead of our technological lead, is driven by a continuous dialogue with customers and marketing. Totally dedicated to the print industry for over a decade, we have a unique insight into needs, from concept to the smallest details; trends in demand, preferences and timelines; and long-term return on investment. AVT’s R&D goal is to improve the Printer's quality, productivity and profitability, and its activities and road map are inspired by these objectives.

The result is new platforms and add-on modules that address the direct operating environment of packaging and label printing. In 2005, we introduced a diversity of add-on modules that enhance and add value to our new generation platforms, generating sweet profits.

It takes a sense of scent to gain market loyalty

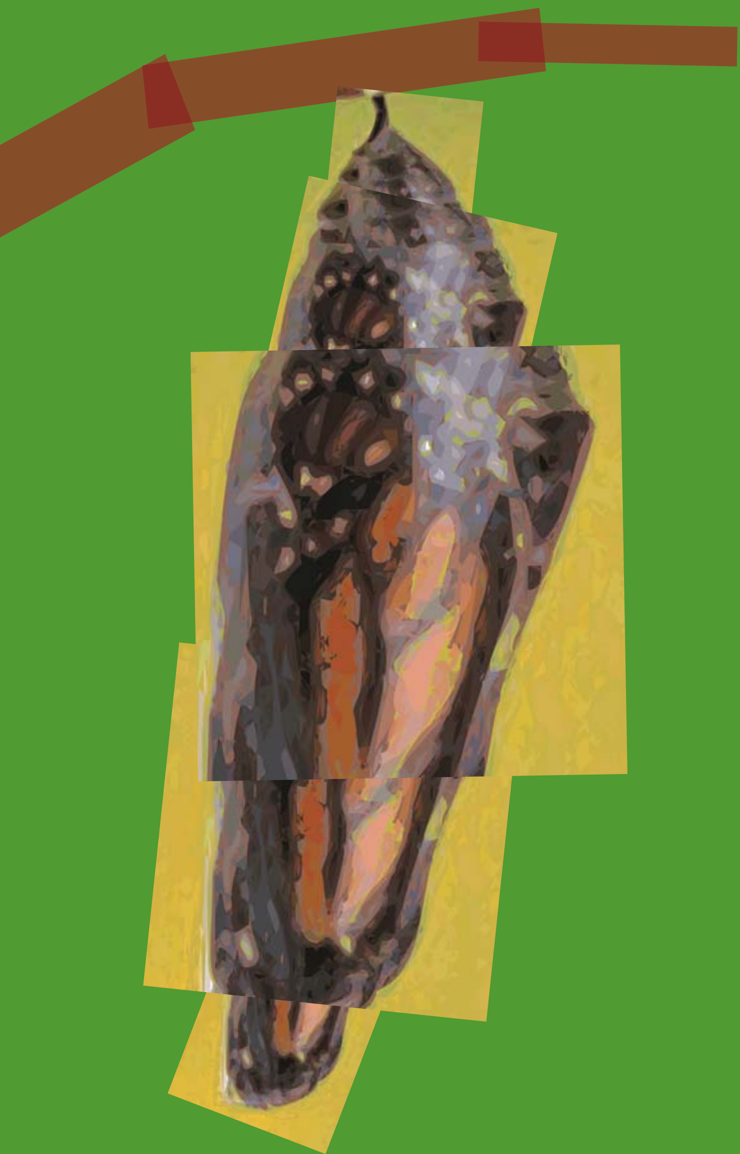
We are proud that a very significant percentage of our customers place repeat orders, procuring multiple solutions based on their excellent experience with our systems and support. This “loyalty” is the best reward a vendor can hope for. Not only is it expressed on the bottom line, but, just as important, it is the strongest recommendation. Our ability to “tune in” to the market, and “scent” out its needs is often expressed in customer testimonials. Quite a few of our major customers, with whom we have a long-term relationship, “stand up” for us, and their positive experiences are related in case histories which illuminate shop floor applications. Now we are striving to build this model of long-term relationships in our targeted emerging markets.

It takes
time and effort to
harvest enduring
success



More than often, trailblazing technologies make a splash and then vanish with the tide. Our goal, from our inception, has been to take root and to grow organically to consistently add value to our platforms, maintain an exciting pipeline, and establish a strong presence in targeted market regions before exploring new territories. We embraced this mature approach to growth even when we were a start-up, educating the market as to the benefits of our breakthrough. Furthermore, from the beginning, we internalized that market leadership must be of duration to be of value. We and our shareholders thus measure our progress not just in quarterly growth, but in market leadership that is enduring while sowing healthy seeds for the future.

It takes vision to welcome the future



A successful company is constantly reborn. New technological developments and marketing challenges call for “out-of-the-box” thinking tempered by an in-depth grasp of the real world environment. Intuition and imagination must be balanced by reason and measurable standards. Thus a technology company must always evince the optimism and creativity of the young, and the steadfastness and responsibility of the adult. These characteristics are translated into innovation, fiscal soundness and foresight. As we move up to the next threshold of our development, we commit to nurturing the qualities that build long-lasting companies for shareholders, customers and employees. Partnering together, we can keep our company young and mature, insightful and prepared for the opportunities the future holds.

Management's Discussion and Analysis of Financial Condition and Results of Operations

We may from time to time make written or verbal forward-looking statements, in reports to shareholders, in press releases and investors' webcasts. You may identify these forward –looking statements by use of words such as "strategy", "expects", "continues", "plans", "anticipates", "believes", "will", "estimates", "intends", "projects", "goals", "targets", and other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

We cannot assure you that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Investors should bear this in mind as they consider forward-looking statements, whether to invest or remain invested in Advanced Vision Technology (AVT) Ltd. securities. The forward-looking statements relate to, among other things: operating results; anticipated cash flows; gross margins; adequacy of resources to fund operations and our ability to maintain average selling prices, despite the aggressive marketing and pricing strategies of our competitors.

The following discussion, analysis of our financial condition and results of operations, should be read in conjunction with our consolidated financial statements, the related notes and other financial information included elsewhere in this annual report.

Overview

AVT was incorporated in October, 1992 and introduced the prototype of its first product, the **PrintVision/9000**, in 1996. Commercial sales of **PrintVision/9000** commenced in the second quarter of 1997.
On April 2003 we launched a new set of products for both the packaging and labels segments of the printing industry:
The **PrintVision/Jupiter** - a new platform, replacing the legacy PrintVision/NT platform, sets new standards for print process control with improved advanced automatic print inspection software.
The **PrintVision/Apollo**- is the quality assurance solution for the packaging industry, and the
PrintVision/Helios- our new solution for the Labels and narrow web printing inspection applications. The PrintVision/Helios can be integrated as a full quality assurance station for post press applications or as an on-line process control system.

In 2004 we introduced the full workflow support and the business management-related solutions, which are practical proofs of our commitment to supporting the growing quality needs and cost reduction of the printing industry. The new solutions for efficient and profitable quality control, include among others the following products:

- **pRegister:** The established module for automatic register pre-setting and control
- **Presco:** The new, innovative module for automatic plate pressure pre-setting and control
- **IΔEal:** An in line color measurement module for ΔE and ΔL*a*b-based color pre-setting guidance and run-time color management.

We established AVT Inc. in October 1996 and AVT (Europe) S.A. in November 1997 to serve as our direct distribution channels in the Americas and Europe. Our products and services are primarily sold directly to end-users; a portion of product sales are sold through distributors and strategic partners. By December 31, 2005 approximately 1,200 PrintVision platforms were installed worldwide. No distributor or end-user accounted for more than 10% of revenues in 2005 and 2004.

On June 19, 2002 we concluded the acquisition of the assets of Geiger Vision Systems GmbH (GVS) of Munich, Germany for a consideration of approximately 1 (one) million Euro. The acquisition of GVS assets (mostly intangible) was a strategic decision to facilitate the penetration into the Labels print market. The acquisition was accounted for as a purchase, and accordingly, the purchase price was allocated to the assets acquired based on their respective fair values. Out of the total consideration, $825 thousand were allocated to goodwill. (See also critical accounting policies) AVT (Germany) GmbH was established in June 2002 to absorb the assets and operations of GVS and became our

Management's Discussion and Analysis of Financial Condition and Results of Operations

selling arm in the German speaking countries in Europe. As of January 1, 2006 AVT (Germany) GmbH commenced serving as our direct distribution and service channel for Europe, consolidating and controlling our European operations.
Our future revenues and operating results may fluctuate on a quarterly and on an annual basis due to a combination of factors, including but not limited to: variations in the timing of orders and deliveries of our products; variations in payment terms; variations in the size of orders and their internal product mix; by our customers; new product introductions; by the Company and its competitors; market acceptance of new products; the expansion and effectiveness of our distribution network; variations in capital spending budgets of print shops; foreign currency exchange rates; and general economic conditions and economic conditions specific to the printing industry.
Exchange rate exposure affects our results as we have both sales and costs in many currencies other than the US Dollar (mainly in Euro). In 2005 the European currency decreased in value relative to the US Dollar by over 15%. In Israel, during 2005, the New Israel Shekel ("NIS") increased in value relative to the US Dollar by approximately 6.8%.

Off-Balance Sheet Transactions

We have not engaged in nor been a party to off-balance sheet transactions.

Information on the Company

Manufacturing. Our manufacturing activities for systems, consist primarily of the assembly and testing of components and subassemblies, that are acquired from third party vendors and subcontractors and then integrated by us into a finished system.
We manufacture our products at our facility in Hod Hasharon, Israel. Our products are built in accordance with industry standard infrastructure and are PC compatible. The hardware elements in our products are based primarily on standard commercial off-the-shelf components and utilize proprietary in-house developed circuit boards and algorithms, as well as image acquisition and image analysis techniques and software.

Service and Support. We have focused on building a strong service and support organization for all our systems and have focused on assisting, the various regions, in which we operate, to be as self sufficient as possible. We maintain at our headquarters a staff of highly skilled customer service engineers, who offer support to our customers and distributors. These service engineers, as well as additional service engineers located in our subsidiaries in the United States and Europe, provide first class field services and support worldwide. We install, service and provide training to customers on all our products. Within a very short time after delivery and a minimum amount of site preparation by the customer, installation of a typical system can usually be completed at the customer's site, either by us or by third parties. Our customer support engineer installs and checks the system. As part of the installation procedure, we provide our customers with system documentation and simple training in maintenance and application. We maintain regular training and installation support sessions for our service engineers and distributors. Our systems are generally sold with a warranty for repairs of hardware and software defects and malfunctions. The usual term of such warranty is one year after installation. In addition, for a fee, we offer customers service and maintenance contracts, commencing after the expiration of the warranty period. Software is licensed, whether contained in optional features or forming an integral part of the functioning capacity of the system. Software updates are typically included in the service fee.

Research & Development. We believe that the development of new products and the enhancement of existing products are essential to our future success. Therefore, we intend to continue devoting substantial resources to research and new product development, and to continuously improve our systems and design processes in order to reduce the cost of our products. Our research and development efforts have been financed through our internal funds and programs sponsored through the Government of Israel. We believe our research and development effort has been an important factor in establishing and maintaining our competitive position.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Marketing and Selling. We market our products for automatic inspection of printed materials and provides customer support directly and through our wholly-owned subsidiaries in the United States and Europe. Each subsidiary employs local marketing, sales and customer support personnel. Worldwide marketing efforts are coordinated by the responsible marketing managers, who are based at Company headquarters in Israel.
Approximately 30 people are engaged in the Company's worldwide selling and marketing efforts, which include participation in various trade shows and conventions, publications and trade press, demonstrations performed in Company facilities and daily contact with customers by sales personnel.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States ("US GAAP"). While all the accounting policies impact the financial statements, certain policies may be viewed to be critical. These policies are those that are both most important to the understanding of our financial condition and results of operations and require our management's most difficult, subjective and complex judgment and estimates. Actual results could differ from those estimates.
For any given individual estimate or assumption, made by us, there may be alternative estimates or assumptions which are also reasonable. We believe, that given the facts and circumstances, at the time of making the relevant judgments, estimates or assumptions, applying any such other reasonable judgment may cause a material effect on our consolidated results of operations, financial position or liquidity, as presented in the consolidated Financial Statements.

Management believes that the significant accounting policies, which affect its more significant judgments and estimates used in the preparation of the consolidated financial statements, are the most critical to aid in fully understanding and evaluating our reported results include the following:

- Revenue Recognition
- Inventory valuation
- Impairment of long lived assets
- Taxes on Income

Revenues. We derive revenues primarily from two sources: product revenues, which include hardware and software. Service revenues, which include, support and maintenance, consulting and training. Revenue related to the sale of our products is generally recognized when persuasive evidence of an agreement exists; the product has been shipped; the sale price is fixed and determinable, no further obligations exist, and collection is probable. If a payment is conditioned by the installation of the product, the revenue recognition of the conditioned amount will be deferred, until installation of the product is completed. In the normal course of business, we do not provide a right of return to our customers. Sales agreements with specific acceptance terms, are not recognized, until the customer has confirmed in writing that the product or service has been accepted.
Revenues from maintenance and professional services are recognized ratably over the contract period, or as services are performed.
When transactions involve multiple elements, revenue is allocated to the elements based on the Vendor Specific Objective Evidence ("VSOE") of the relative fair values of each element in the arrangement. The best evidence of fair value is the price of a deliverable when it is regularly sold on a standalone basis. VSOE of fair value is limited to (a) the price charged for a deliverable when it is sold separately or (b), for a deliverable not yet being sold separately, the price established by management having the relevant authority.

Inventory valuation. At each balance sheet date, we evaluate our inventory balance for excess quantities and obsolescence. This evaluation includes analysis of sales levels by product line and projection of future demand. In addition, we write off inventories that are considered obsolete. Remaining inventory balances are adjusted to the lower of cost or market value. If future demand or market conditions are less favorable than our projections, additional inventory write- downs may be required and would be reflected in cost of sales in the period the revision is made.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Impairment of Long Lived Assets. Our long-lived assets include property and equipment, goodwill and other intangible assets. In assessing potential impairment of the long-lived assets, we consider the projected contribution of that asset, to our results of operations and other pertinent information. We will record an asset impairment charge when we believe that the asset has experienced a decline in value that is other than temporary. Based on our evaluation, during 2005 we did not record any impairment charge related to our long-lived assets. As of December 31, 2005, the carrying value of our long-lived assets was $1,358 thousand.

In assessing the recoverability of our property and equipment, goodwill and other intangible assets, we must make assumptions regarding the estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets.

During the fourth quarter of 2005 we performed our annual impairment test of acquired intangible assets as prescribed by SFAS No, 142. This evaluation indicated that an impairment loss does not exist.

We will perform impairment test at least annually and on interim basis, should circumstances indicate that an impairment loss may exist. The outcome of such testing may lead to the recognition of an impairment loss. As of December 31, 2005 we had $825 thousand of non-amortized goodwill.

Taxes on Income. Taxes on income are calculated based on the Company's assumptions as to its entitlement to various benefits under the Approved Enterprise Law. The Company's entitlement to such benefits is conditional upon its compliance with the terms and conditions prescribed in this law.

We record income taxes using the asset and liability approach. Deferred income tax assets and liabilities are recognized for future tax consequences, attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and net operating loss and tax credit carryforwards. Our financial statements contain fully reserved tax assets which have arisen as temporary differences between book and tax accounting. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance, recorded against our net deferred tax assets. We have considered future taxable income, prudent and feasible tax planning strategies and other available evidence, in determining the need for a valuation allowance. We evaluate all of these factors to determine whether it is more likely than not, that some portion or all of the deferred income tax assets will not be realized. If the realization of deferred tax assets in the future is considered more likely than not, an adjustment to the deferred tax assets would increase net income, in the period such determination was made.

Our effective tax rate may vary from period to period based on changes in estimated taxable income or loss, changes to the valuation allowance, changes to state or foreign tax laws, future expansion into geographic areas with varying country, state and local income tax rates, deductibility of certain costs and expenses by jurisdiction and as a result of acquisitions, divestitures and reorganizations.

Our Consolidated Financial Statements are prepared in US Dollars. Substantially all of our revenues are made outside Israel in US Dollars. Sales in the United States and other regions except for the European Union are typically denominated in US Dollars, sales in Europe are primarily in Euro, US Dollars or Pound Sterling. Furthermore, a portion of our costs are incurred in US Dollars and another portion is incurred in New Israel Shekel ("Shekel" or "NIS") and Euro. Since the US Dollar is the primary currency in the economic environment in which the Company operates, the US Dollar is its functional currency and accordingly, monetary accounts maintained in currency other than the US Dollar are re-measured using the foreign exchange rate at the balance sheet date and transaction gains and losses from re-measurements are reflected in the Statement of Operations as financial income or expenses, as appropriate.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Impact of Inflation and Exchange risk

Historically, the Israeli currency, the NIS has been devalued in relation to the US Dollar and other major currencies, principally to reflect the extent to which inflation in Israel exceeds average inflation rates in western economies. Such devaluations in any particular fiscal period are never completely synchronized with the rate of inflation, the annual rate of devaluation of the NIS against the US Dollar and the gap between them for the periods indicated:

Year Ended December 31,	2005	2004	2003
Inflation	2.5	1.2	(1.9%)
Devaluation (Revaluation)	(7.5%)	(1.6%)	(7.6%)
Inflation (devaluation) gap	10.0%	2.8%	5.7%

Although a material portion of our costs relate to the operations in Israel, part of these Israeli costs are denominated in US Dollars or linked thereto. Costs not denominated in, or linked to, US Dollars are converted to US Dollars, when recorded, at the then prevailing exchange rates. To the extent such costs are linked to the Israeli Consumer Price Index, such costs may increase, if the rate of inflation in Israel exceeds the rate of devaluation on the Shekel against the US Dollar, or if the timing of such devaluations were to lag considerably behind inflation. Conversely, such costs may, in US Dollar terms, decrease if the rate of inflation is lower than the rate of devaluation of the Shekel against the US Dollar.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Operating Results

The following table sets forth selected consolidated income statements data for each of the three years ended December 31, 2003, 2004, and 2005 expressed as a percentage of total revenues.

Year Ended December 31,	2005	2004	2003
Revenues	100%	100%	100%
Products	94.5	94.7	94.4
Services	5.5	5.3	5.6
Cost of Revenues	38.5	38.7	41.1
Gross Profit	61.5	61.3	58.9
Operating Expenses			
Research and development, gross	13.2	15.5	22.0
Grants and participations	(1.2)	(2.8)	(5.2)
Selling and Marketing	23.9	30.4	29.5
General and administrative	9.6	9.1	10.0
Restructuring Expenses and other	0	0	0.5
Amortization of deferred stock compensation	0.1	1.0	1.9
Total Operating Expenses	45.6	53.2	58.7
Operating Income	15.9	8.1	0.2
Financial Income, net	0.1	3.1	4.2
Profit before taxes on Income	16.0	11.2	4.4
Taxes on Income	0.7	(0.9)	(1.6)
Net Income	16.7	10.3	2.8

Year ended December 31, 2005, compared with year ended December 31, 2004.

2005 continued the growth trend we have experienced in prior years and broke new records in terms of Revenues and profitability. We are proud to present our 2005 success and achievements and look forward to continue this growth trend into 2006.

Revenues

Revenues are derived primarily from the sale of our systems; additional revenues are generated through the sale of support services, training and software updates to customers.

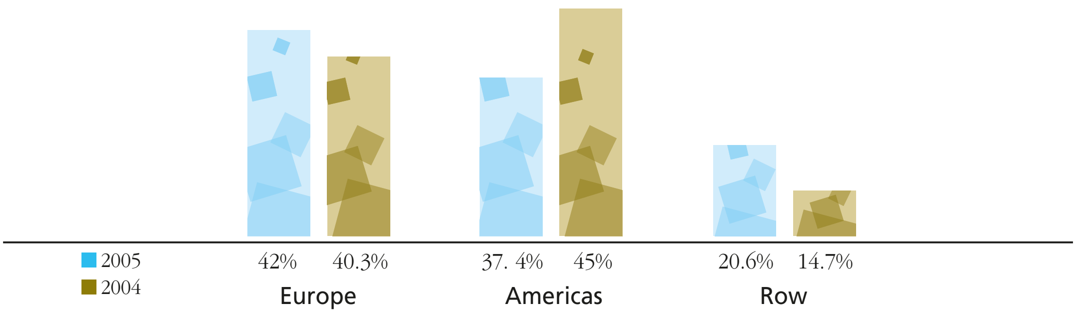
Revenues in 2005 totaled $25,143 thousand representing an increase of 17.7% over the revenues of 2004. The 2005 Revenues constitute a track record and are the highest we ever recorded. The increase in Revenues is attributable to the good market conditions we have experienced in the US and Europe, and the expansion in Latin America, China

Management's Discussion and Analysis of Financial Condition and Results of Operations

and other Asian markets. During 2005 we continued the penetration into the Labels market. Revenues from our labels products accounted for approximately 20% of our annual Revenues compared with 15% of Revenues in 2004.

Revenues from services are generated from maintenance, training and support fees. We recognize service revenues over the contractual period or as services are performed. Service revenues in 2005 totaled $1,374 thousand (out of the total revenues of $25,143 thousand) 22.5% higher than the $1,122 thousand recorded in 2004.
During 2005 order booking totaled $26,119 thousand representing an increase of 10% over 2004 order booking of $23,740 thousand. The ratio of order booking to Revenues in 2005 was 104% demonstrating our growth and improved visibility. As of December 31, 2005 order back-log totaled $8,753 thousand an increase of 9.0% over the balance at December 31, 2004, providing us with a visibility of more than one quarter of Revenues. We estimate that out of this back-log, 65%-75% will become Revenue during Q1 of 2006, while the remainder will become revenue in the following three quarters. The increase in order booking is attributable to the improvement of market conditions, for both our packaging and labels solutions, in the US and Europe and to the deeper penetration into China and the Asian markets.

The following chart sets forth breakdown of Revenues by territory for each of the two years ended December 31, 2004 and 2005

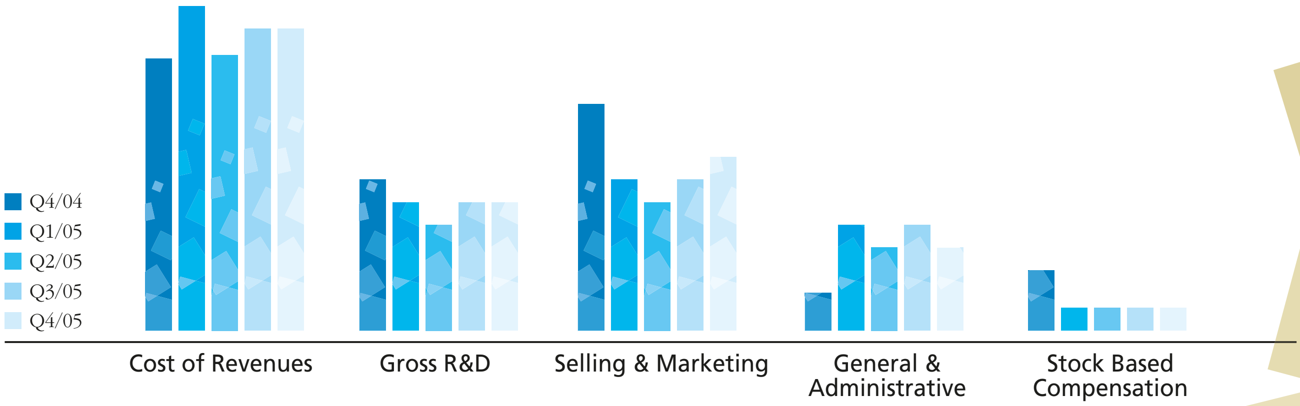


Cost of Revenues / Gross Profit

Cost of revenues includes materials, labor, and an estimate of costs associated with installation, warranty and training. We generally provide a one-year warranty to the end- user. A provision, based on our experience and engineering estimates, is recorded to cover probable costs in connection with such warranty, for the 12 month period commencing at the end of installation.
In 2005 Gross Margin increased slightly, to 61.5%, up from 61.3% in 2004. While Gross Profit is usually in the range of 61%-62%, minor fluctuations are expected as a result of product mix. Software options generally increase the platform's selling price, while keeping the same bill of material cost, and consequently improving the Gross Profit.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following table sets forth selected consolidated Expenditures data for each of the five quarters ended 31.12.2004, 31.3.2005, 30.6.2005, 30.9.2005 and 31.12.2005 expressed as a percentage of total revenues.



Quarter	Cost of Revenues	Gross R&D	Selling & Marketing	General & Administrative	Stock Based Compensation
Q4/04	37.6%	14.1%	34.4%	6.7%	0.9%
Q1/05	39.7%	13.6%	24.2%	9.9%	0.2%
Q2/05	37.5%	12.7%	21.6%	9.4%	0.2%
Q3/05	38.1%	13.3%	23.4%	9.8%	0.0%
Q4/05	38.6%	13.2%	26.2%	9.4%	0.2%

Research and Development Costs

Research and Development costs are charged to the Statement of Operations as incurred. Government funding for the development of approved projects is recognized as a reduction of expenses as the related costs are incurred. Gross Research and Development expenses remained in 2005 at the same level as in 2004, approximately $3,317 thousand. R& D expenses were partially offset by certain government grants and participations. In 2005, total government grants and participations were $312 thousand compared with $610 thousand during 2004. The decrease in the grants is attributable to the overall decrease in grants provided by the Chief Scientist in Israel during 2005. The funds available for Office of the Chief Scientist grants, out of the annual budget of the State of Israel, were reduced in recent years, and the Israeli authorities have indicated in the past that the government may further reduce or abolish Office of the Chief Scientist grants in the future. Even if these grants are maintained, we cannot presently predict what would be the amounts of future grants, if any, that we might receive.

Selling and Marketing Expenses

In 2005, Selling and Marketing expenses decreased by 7.3% compared to 2004. The decrease is attributable to the adjustment of the selling expenses to the current level of business. The decrease in marketing expenses is also attributable to a partial repayment of a loan to the Marketing Fund of the Israeli Ministry of Trade and Industry that was recorded in 2004 and closed the outstanding debt to the ministry. Selling and Marketing expenses in the fourth quarter of 2005, were higher than in the other quarters of 2005, due to participation in several trade shows in China and Europe, in the second half of the year, as well as other marketing activities, that were concentrated towards the end of the year, in preparation for future growth.

General and Administrative Expenses

General and Administrative expenses increased by 24.3% in 2005. The increase is mostly attributable to the business development activities conducted by us and to the Directors compensation approved by the Extraordinary General Meeting of shareholders, following the appointment of a new professional Board of Directors in Q2 of 2004.

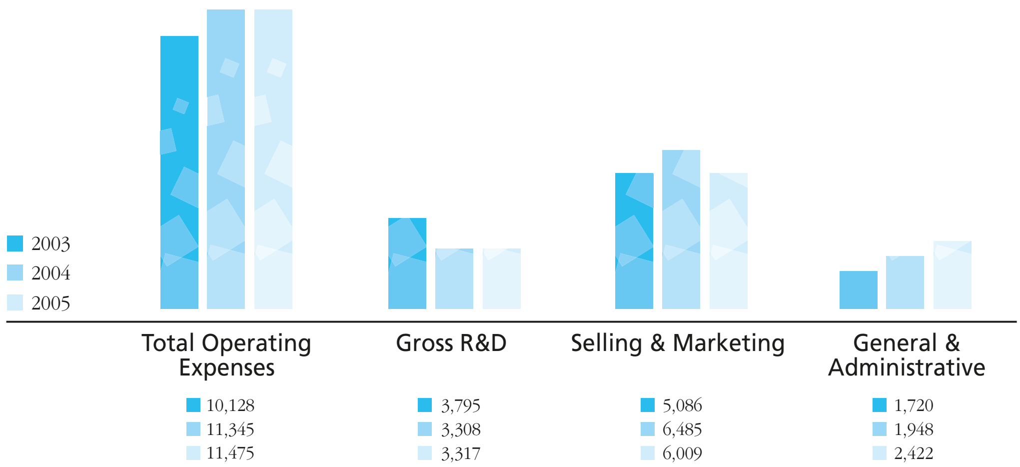
Amortization of deferred stock compensation

On June 26, 2002 we adjusted to $0 the exercise price of all options granted, up to June 3, 2002, to our employees and directors pursuant to our Stock Option Plans. This adjustment applied only to options that have not been exercised as of June 3, 2002, and was not applied to options granted to employees, who as of that day, were no longer employed by us. Total amortization of deferred stock compensation recorded during 2005- $39 thousand, represents the benefit

Management's Discussion and Analysis of Financial Condition and Results of Operations

for all vested options as of December 31, 2005. Based on SFAS 123R we will have to record share-based payments as expenses based on their fair value, commencing January 1, 2006. The compensation will be recorded over the requisite service period. During 2006 we will apply the Modified Prospective without restatement (MPA) method and will record the previous unvested awards measured according to SFAS 123 and the new awards measured according to SFAS 123R. The measurement of the benefit will be based on the Lattice model.

Analysis of consolidated Operating Expenses for each of the three years ended December 31, 2003, 2004, and 2005:



Operating and Net Income

Proforma Operating Income for 2005 (excluding amortization of deferred stock compensation) increased from a profit of $1,955 thousand in 2004 to a profit of $4,038 thousand in 2005 representing an increase of 107%. Proforma Operating Income represented 16.1% of revenues in 2005 compared with 9.2% of revenues in 2004. EBITDA for 2005 increased by 88% from a profit of $2,291 thousand in 2004 to a profit of $4,310 thousand. Proforma Operating Income for Q4/2005 was $906 thousand compared with a profit of $582 thousand in Q4/2004 representing an increase of 56%.

Net Income for the full year ended December 31, 2005 was $4,201 thousand, or $0.90 per share (diluted) compared with a net income of $2,203 thousand for 2004, or $0.48 per share (diluted).

Financial Income, Net

Net Financial income in 2005 was $30 thousand compared with $661 thousand in 2004.

Financial income is comprised of interest incurred on time deposits and bonds, less interest expenses on lines of credit and exchange rate differences between the US dollar and the Euro. The decrease in financial income is attributable to the devaluation of the Euro and the Israeli currency to the US dollar during 2005. Financial Income for 2005 accounted for $686 thousand compared to $770 thousand for 2004, offset by exchange rate differences and other interest and bank charges of $656 thousand during 2005.

Taxes

We operate within multiple taxing jurisdictions and are subject to audit in those jurisdictions. During 2005 the Israeli tax authorities concluded a tax assessment for the years 2001-2004. We have incorporated the results of that assessment in the tax expenses on the Statement of Operations. During 2003 we conducted a Transfer Pricing study in the United States and during 2005 we conducted a study in Europe. The recommendations of those studies were incorporated in our tax estimates. In our opinion, an adequate asset and provision for income taxes has been made in the financial statements. This asset and provision takes into consideration the tax reform effective in Israel as of January 1st 2003 and potential tax liability in other jurisdictions.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Liquidity and Capital Resources

As of December 31, 2005 we had approximately $25.4 million of cash and cash equivalents, short and long-term investments compared with $21.1 million at December 31, 2004. The increase of cash level in 2005 is due to the increase in revenues and order intake and to our increased profitability.

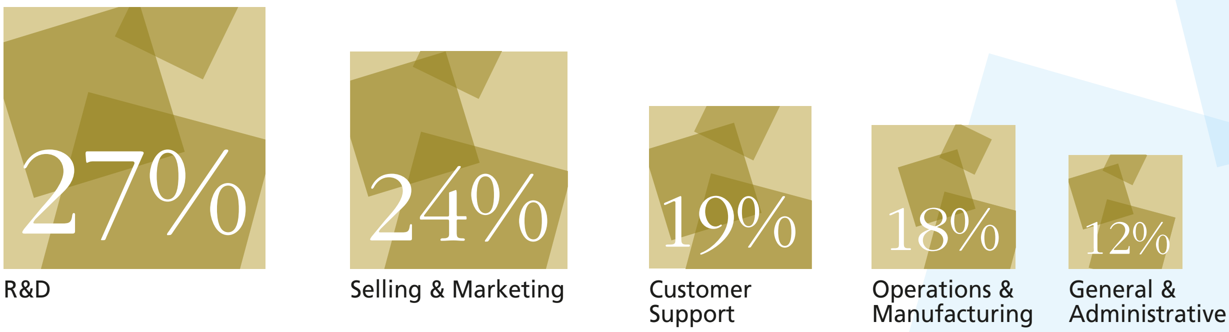
In 2005, $4,451 thousand were provided by operating activities compared with $1,335 thousand in 2004. The increase in cash, provided from operating activities, is attributable to the increase in turn over and profitability. Our inventory balance is net of old and slow inventories that were written off during 2005. The balance represents the level of inventory necessary to facilitate our current production level. We focus on managing our working capital, particularly in maintaining the relative low level of Accounts Receivable Days Sales Outstanding (DSO) and inventories. DSO in accounts receivable for 2005 was 61 days compared with 54 days at the end of 2004. Our 2005 capital expenditures on fixed assets were $ 160 thousand compared with $155 thousand used during 2004. As of December 31, 2005 we have no commitment for capital expenditures.

Employees

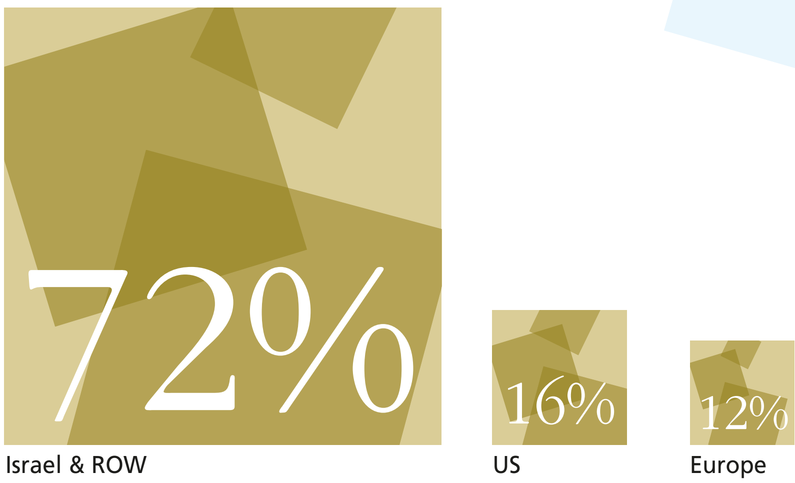
Our employees consistently remain our major assets, committed to the drive for technological leadership and outstanding customer service. Our dedicated team has repeatedly demonstrated that it shares our vision, and has the motivation, innovation and commitment to customer satisfaction which are the key ingredients of healthy growth.

On December 31, 2005, 109 people were employed by AVT worldwide compared with 110 at December 31, 2004.

The breakdown of employees by activity is as follows:



Our emloyees are based in the following areas per their subsidiary affiliation:



Financial

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Report of Independent Auditors

To the shareholders of
Advanced Vision Technology (A.V.T.) Ltd.

ERNST & YOUNG

We have audited the accompanying consolidated balance sheets of Advanced Vision Technology (A.V.T.) Ltd. (the "Company") and its subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States.

Kost, Forer Gabbay and Kasierer

Tel-Aviv, Israel
March 29, 2006

Kost Forer Gabbay & Kasierer
A Member of Ernst & Young Global

Consolidated Balance Sheets

U.S. dollars in thousands

December 31,	2005	2004
Assets		
Current assets:		
Cash and cash equivalents	7,701	4,836
Marketable securities	9,227	7,992
Trade receivables (net of allowance for doubtful accounts		
of $ 53 at December 31, 2005 and 2004)	4,421	3,506
Other accounts receivable and prepaid expenses	1,463	1,457
Inventories	2,462	3,200
Total current assets	25,274	20,991
Long-term investments:		
Marketable securities	8,505	8,235
Severance pay fund	1,195	1,099
Total long-term investments	9,700	9,334
Deferred taxes	337	-
Property and equipment, net	533	588
Goodwill	825	825
Technology (net of accumulated amortization		
of $ 206 and $ 149 at December 31, 2005		
and 2004, respectively)	-	57
Total assets	36,669	31,795

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

Consolidated Balance Sheets

U.S. Dollars in thousands (except share and per share amounts)

December 31,	2005	2004
Liabilities and shareholders' equity		
Current liabilities:		
Trade payables	1,042	1,050
Employees and payroll accruals	1,253	1,129
Customer advances	998	1,072
Accrued expenses and other liabilities	2,731	2,544
Total current liabilities	6,024	5,795
Accrued severance pay	1,884	1,609
Commitments and contingent liabilities		
Shareholders' equity:		
Share capital:		
Ordinary shares of NIS 2 par value: 7,013,500 shares authorized		
at December 31, 2005 and 2004; 6,300,492 and 6,235,591		
shares issued at December 31, 2005 and 2004, respectively;		
4,417,740 and 4,344,839 shares outstanding at		
December 31, 2005 and 2004, respectively	3,402	3,373
Additional paid-in capital	54,721	54,697
Deferred stock-based compensation	-	(49)
Treasury shares at cost	(15,866)	(15,933)
Accumulated deficit	(13,496)	(17,697)
Total shareholders' equity	28,761	24,391
Total liabilities and shareholders’ equity	36,669	31,795

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

Consolidated Statement Of Operations

U.S. Dollars in thousands (except share and per share amounts)

Year Ended December 31,	2005	2004	2003
Revenues	25,143	21,358	17,264
Cost of revenues *)	9,669	8,272	7,096
Gross profit	15,474	13,086	10,168
Operating expenses:			
Research and development *	3,317	3,308	3,795
Less - grants and participation	(312)	(610)	(892)
Selling and marketing *)	6,009	6,485	5,086
General and administrative *)	2,422	1,948	1,720
Restructuring expenses	-	-	83
Amortization of deferred stock-based compensation	39	214	336
Total operating expenses	11,475	11,345	10,128
Operating income	3,999	1,741	40
Financial income, net	30	661	725
Income before taxes on income	4,029	2,402	765
Taxes on income (tax benefit)	(172)	199	271
Net income	4,201	2,203	494
Basic net earnings per share	0.96	0.51	0.10
Diluted net earnings per share	0.90	0.48	0.09
*)Expenses are excluded of stock-based compensation			
expense to employees and others as follows:			
Cost of revenues	2	11	18
Research and development, net	6	31	48
Selling and marketing	10	56	88
General and administrative	21	116	182
Total stock compensation expense	39	214	336

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

Consolidated statements of Changes in Shareholders' Equity

U.S. Dollars in thousands (except share and per share amounts)

	Share capital	Additional paid-in capital	Deferred stock-based compensation	Treasury shares	Accumulated deficit	Total Shareholders' equity
Balance as of January 1, 2003	3,075	55,083	(642)	-	(20,394)	37,122
Exercise of options	243	(243)	-	-	-	-
Adjustment of issuance costs related to initial public offering	-	(48)	-	-	-	(48)
Reversal of deferred stock-based compensation upon forfeiture of options	-	(43)	43	-	-	-
Amortization of deferred stock-based compensation	-	-	336	-	-	336
Purchase of 1,890,752 treasury shares	-	-	-	(15,933)	-	(15,933)
Net income	-	-	-	-	494	494
Balance as of December 31, 2003	3,318	54,749	(263)	(15,933)	(19,900)	21,971
Exercise of options	55	(52)	-	-	-	3
Amortization of deferred stock-based compensation	-	-	214	-	-	214
Net income	-	-	-	-	2,203	2,203
Balance as of December 31, 2004	3,373	54,697	(49)	(15,933)	(17,697)	24,391
Exercise of options	29	16	-	-	-	45
Sale of treasury shares	-	18	-	67	-	85
Reversal of deferred stock-based compensation upon forfeiture of options	-	(10)	10	-	-	-
Amortization of deferred stock-based compensation	-	-	39	-	-	39
Net income	-	-	-	-	4,201	4,201
Balance as of December 31, 2005	3,402	54,721	-	(15,866)	(13,496)	28,761

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

Consolidated Statements of Cash Flows

U.S. dollars in thousands

Year Ended December 31,	2005	2004	2003
Cash flows from operating activities:			
Net income	4,201	2,203	494
Adjustments to reconcile net income to net			
cash provided by operating activities:			
Amortization of deferred stock-based compensation	39	214	336
Depreciation and amortization of property,			
equipment and technology	272	321	378
Amortization of marketable securities			
premium and accretion of discount	51	205	378
Increase in trade receivables	(915)	(999)	(715)
Decrease (increase) in other accounts receivable			
and prepaid expenses	(6)	330	96
Decrease (increase) in inventories	738	(1,053)	(359)
Deferred taxes	(337)	-	-
Increase (decrease) in trade payables	(8)	135	389
Increase in employees and payroll accruals	124	399	21
Increase (decrease) in customer advances, accrued expenses			
and other liabilities	113	(465)	218
Increase in accrued severance pay, net	179	45	97
Net cash provided by operating activities	4,451	1,335	1,333
Cash flows from investing activities:			
Proceeds from marketable securities	7,940	7,505	13,148
Purchase of marketable securities	(9,496)	(10,500)	-
Purchase of property and equipment	(160)	(155)	(277)
Net cash provided by (used in) investing activities	(1,716)	(3,150)	12,871
Cash flows from financing activities:			
Adjustment of issuance costs related to initial public offering	-	-	(48)
Purchase of treasury shares at cost	-	-	(15,933)
Proceeds from sale of treasury shares	85	-	-
Proceeds from exercise of options	45	3	-
Net cash provided by (used in) financing activities	130	3	(15,981)
Increase (decrease) in cash and cash equivalents	2,865	(1,812)	(1,777)
Cash and cash equivalents at the beginning of the year	4,836	6,648	8,425
Cash and cash equivalents at the end of the year	7,701	4,836	6,648

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

Notes to Consolidated Financial Statements

1 General

Advanced Vision Technology (A.V.T.) Ltd. ("A.V.T.") was incorporated under the laws of the State of Israel on December 10, 1992 and commenced operations thereafter. A.V.T. and its wholly-owned subsidiaries ("the Company") design, develop, manufacture, market and support an advanced video-based print inspection system that automatically detects defects in various types of printing processes.

The Company's products are marketed and supported in the U.S. and Europe through its wholly-owned subsidiaries, Advanced Vision Technology Inc. located in the United States, Advanced Vision Technology (Europe) S.A. located in Belgium, and Advanced Vision Technology (Germany) GmbH.

2 Significant accounting policies

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"), including relevant accounting and financial reporting pronouncements promulgated by the U.S. Securities and Exchange Commission ("SEC").

a. Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

The majority of the Company's revenues are generated in U.S. dollars ("dollar"). In addition, a substantial portion of the Company's costs is incurred in dollars. The Company's management believes that the dollar is the currency of the primary economic environment in which the Company operates. Thus, the functional and reporting currency of the Company and its subsidiaries is the dollar.

Accordingly, transactions and monetary accounts maintained in currencies other than the dollar are remeasured into dollars in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation" ("SFAS No. 52"). All transactions gains and losses from the remeasurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses as appropriate.

c. Principles of consolidation:

The consolidated financial statements include the accounts of A.V.T. and its wholly-owned subsidiaries. Intercompany transactions and balances, including profits from intercompany sales not yet realized outside the Company, have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents include short-term highly liquid investments that are readily convertible to cash with original maturities of three months or less.

e. Marketable securities:

The Company accounts for its investments in marketable securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

2 Significant accounting policies (Cont.)

Management determines the appropriate classification of its investments in marketable debt securities at the time of purchase and reevaluates such determinations at each balance sheet date. Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity and are stated at amortized cost.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and interest are included in financial income, net.

The Company's investments in debt securities are diversified among high-credit quality securities, in accordance with the Company's investment policy.

f. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs are provided to cover risks arising from slow-moving items or technological obsolescence.

Cost is determined as follows:

Raw materials - according to the “average cost method”.
Work in progress - based on direct manufacturing costs.
Finished products - based on direct manufacturing costs and allocable indirect manufacturing costs.

The Company evaluates periodically the quantities on hand relative to current selling prices and historical and forecasted sales volume. Based on these evaluations, provisions are recorded, if required, to write-down inventory to its net realizable value. Such provisions are included in the cost of revenues. To date, inventory write-downs have been immaterial.

g. Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method, over the estimated useful lives of the assets, at the following annual rates:

	%
Computers and peripheral equipment	20 - 33
Machinery and equipment	6 - 20
Office furniture and equipment	6 - 20
Leasehold improvements	The shorter of the term of the lease or the useful life of the asset

Long-lived assets of the Company are reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", whenever events or change in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. No impairment losses have been identified during 2005, 2004 and 2003.

2 Significant accounting policies (Cont.)

h. Other assets:

In June 2002, the Company acquired certain assets constituting a business from Geiger Vision Systems GmbH. The acquisition was accounted for by the purchase method of accounting. Accordingly, cost of $ 206 was allocated to the estimated fair value of developed technology and cost of $ 825 was allocated to goodwill.

Goodwill represents the excess of the costs over the fair value of the net assets of an acquired business. Under SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") goodwill is not amortized, but tested for impairment at least annually or more frequently if certain indicators of possible impairment arise. Goodwill is tested for impairment by comparing the fair value of the Company to its carrying value, including goodwill. Fair value is determined using market capitalization. The fair value of the Company has exceeded its book value and therefore no write-down of goodwill was required in the reported periods.

Technology acquired in a business combination was amortized using the straight-line method over the estimated benefit period of 3.5 years. Amortization expense for the years ended December 31, 2005, 2004 and 2003 was $ 57, $ 58 and $ 59, respectively.

i. Research and development costs:

Research and development costs are charged to the statements of operations as incurred.

j. Revenue recognition:

The Company derives its revenues from selling of printing inspection systems to packaging and label converters and printing press manufacturers through Original Equipment Manufacturer ("OEM") partners. The company has additional Revenues from maintenance, support and repair services, related to the abovementioned sales.

Revenues from product sales are recognized in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition", when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the seller's price to the buyer is fixed or determinable, no further obligation exists and collectibility is reasonably assured. The Company provides product installation and training services, which are considered not essential to the functionality of the products and the Company does not grant its customers any rights of return.

The Company adopted Emerging Issues Task Force Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables", and concluded that its entire arrangement represents one unit of accounting. Accordingly, payments which are contingent upon performance are deferred until the contingency is resolved.

Revenues from repair services are recognized at the time the services are rendered while revenues from maintenance and support agreements are deferred and recognized on a straight-line basis over the term of the agreement. Upfront payments for sales, not yet recognized, are recorded as customer advances.

2 Significant accounting policies (Cont.)

k. Warranty costs:

The Company provides twelve months warranty for its products at no charge.

The Company estimates the costs, that may be incurred during the warranty period, and records a liability in the amount of such costs, at the time revenue from the product sale is recognized.

Changes in the Company’s provision for warranty during the period are as follows:

U.S. Dollars in thousands

	2005	2004
Balance, beginning of year	364	351
Warranties expired during the year	(364)	(351)
Warranties issued during the year	548	364
Balance, end of year	548	364

l. Concentrations of credit risk:

Cash and cash equivalents are deposited with major banks in Israel and the United States. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions, in which the Company’s funds are invested, are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

The Company’s marketable securities comprise investments in bonds of U.S. corporations. Management believes that those corporations are financially sound and the portfolio is well diversified. Accordingly, minimal credit risk exists with respect to these marketable securities.

The trade receivables are mainly derived from sales to customers located primarily in the United States and Europe. In certain circumstances, the Company may require letters of credit or other collateral. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection.

The Company has no off-balance-sheet concentration of credit risk such as forward exchange contracts, option contracts or other foreign currency hedging arrangements.

m. Stock-based compensation:

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

Notes to Consolidated Financial Statements

2 Significant accounting policies (Cont.)

The Company adopted the disclosure provisions of SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure", which amended certain provisions of SFAS No.123, “Accounting for Stock-Based Compensation” (“SFAS 123”), to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. The Company continues to apply the provisions of APB 25 in accounting for stock-based compensation.

Pro forma information regarding net income (loss) and earnings (loss) per share is required by SFAS 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS 123. The fair value for these options was estimated at the date of grant, using the Black-Scholes Option Valuation Model through the beginning of 2005 and the Monte Carlo simulation for options granted thereafter, with the following weighted-average assumptions for 2005, 2004 and 2003: risk-free interest rates of 3.5%, 3.9% and 3.3%, respectively; dividend yields of 0% for each of those years, volatility of price of the Company's shares of 0.70, 0.50 and 0.52, respectively and a weighted-average expected life of the option of one year after the vesting period, which is generally three to four years.

Pro forma information under SFAS 123 is as follows:

U.S. Dollars in thousands (except share and per share amounts)

Year Ended December 31,	2005	2004	2003
Net income as reported	4,201	2,203	494
Add - stock-based employee compensation - intrinsic value included in reported net income	39	214	336
Deduct - stock-based employee compensation - fair value	(539)	(810)	(946)
Pro forma net income (loss)	3,701	1,607	(116)
Basic net earnings per Ordinary shares, as reported	0.96	0.51	0.10
Diluted net earnings per Ordinary shares, as reported	0.90	0.48	0.09
Pro forma basic net earnings (loss) per share	0.85	0.37	(0.02)
Pro forma diluted net earnings (loss) per share	0.81	0.35	(0.02)

n. Royalty-bearing grants:

Royalty-bearing grants from the Chief Scientist of the Ministry of Industry and Trade in Israel for funding certain approved research and development projects and from the Fund for the Encouragement of Marketing Activities for funding marketing activities are recognized at the time the Company is entitled to such grants on the basis of the related costs incurred and are included as a deduction from research and development costs and from selling and marketing costs, respectively.

Research and development grants recognized amounted to \$ 312, \$ 610 and \$ 892 in 2005, 2004 and 2003, respectively. Total royalties accrued or paid amounted to \$ 881, \$ 747 and \$ 604 in 2005, 2004 and 2003, respectively and were recorded in the cost of revenues.

No marketing grants were received during 2005, 2004 and 2003. Total royalties accrued or paid to the Fund for the Encouragement of Marketing Activities amounted to \$ 76, \$ 243 and \$ 138 in 2005, 2004 and 2003, respectively, and were recorded as selling and marketing expenses.

Notes to Consolidated Financial Statements

2 Significant accounting policies (Cont.)

o. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, other accounts receivable, trade payables and other current liabilities approximate their fair value due to the short-term maturity of such instruments.
The fair value of the marketable securities is based on quoted market prices (see Note 3).

p. Severance pay:

The Company's liability for its Israeli employees severance pay is calculated pursuant to the Israeli severance pay law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof. The Company's liability for all of those employees is covered by monthly deposits with severance pay funds, insurance policies and by an accrual.

The deposited funds may be withdrawn only upon fulfillment of the obligation pursuant to the Israeli severance pay law or labor agreements. The value of the insurance policies is based on the cash redeemable value. The funds and insurance policies are recorded as an asset in the Company's balance sheet.

Severance expense for the years ended December 31, 2005, 2004 and 2003 amounted to \$ 288, \$ 194 and \$ 325, respectively.

q. Basic and diluted net earnings per share:

Basic net earnings per share are computed based on the weighted average number of shares outstanding during each year. Diluted net earnings per share are computed based on the weighted average number of shares outstanding during each year, plus potential dilution of equivalent shares considered outstanding during the year, in accordance with SFAS No. 128, "Earnings per Share".

r. Income taxes:

Income taxes are accounted for in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes". This Statement prescribes the use of the liability method whereby deferred tax assets and liabilities are determined based on temporary differences between financial reporting and tax basis of assets and liabilities and for carryforward losses. Deferred taxes are measured using the enacted tax rates that will be in effect when the differences are expected to reverse. A valuation allowance is provided, if necessary, to reduce deferred tax assets to the amount expected to be realized.

s. Impact of recently issued accounting pronouncements:

1. On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued Statement No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)"), which is a revision of FASB Statement No. 123. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, Statements 123 permitted, but did not require, share-based payments to employees to be recognized based on their fair values while SFAS No. 123(R) requires all share-based payments to employees to be recognized based on their fair values. In addition, SFAS No. 123(R) revises, clarifies and expands guidance in several matters, including measurement of fair value, classification of an award as equity or liability and attribution of compensation cost to respective reporting periods. SFAS No. 123(R) permits public companies to adopt its requirements using one of the following two methods:

A "modified prospective" method in which compensation cost is recognized beginning at the effective date as follows:

2 Significant accounting policies (Cont.)

(a) for all share-based payments granted after the effective date - based on the requirements of SFAS No.123(R) and (b) for the unvested portion of all awards granted to employees prior to the effective date of SFAS No. 123(R) - based on the requirements of SFAS No. 123.

A "modified retrospective" method which permits entities to restate their prior years financial statements, based on the amounts previously reported under SFAS No. 123 for purpose of pro forma disclosures.

The Company plans to adopt SFAS No. 123(R) using the modified prospective method.

In March 2005, the SEC released Staff Accounting Bulletin No. 107, "Share Based Payment" (SAB 107). SAB 107 provides the SEC's staff position regarding the application of SFAS No. 123(R) and contains interpretive guidance relating to the interaction between SFAS No. 123(R) and certain SEC rules and regulations, and also provides the SEC staff's view regarding the valuation of share-based payment arrangements for public companies. SAB 107 highlights the importance of disclosure made related to the accounting for share-based payment transactions.

On April 14, 2005 the SEC issued a ruling that allows companies to implements SFAS No. 123(R) at the beginning of the next fiscal year, instead of the next reporting period, that commenced after June 30, 2005. Accordingly the Company will implements SFAS No. 123(R) effective as of January 1, 2006.

As permitted by SFAS No. 123, the Company currently accounts for share-based payments to employees using APB No. 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. In addition, non-compensatory plans under APB No. 25 will be considered compensatory for SFAS No. 123(R). Accordingly, the adoption of SFAS No. 123(R)'s fair value method will have significant impact on the Company's result of operations, although it will have no impact on the Company's financial position. The impact of adoption of SFAS No. 123(R) cannot be predicted at this stage, as it depends on levels of share-based payments that will be granted in the future. However, had the Company adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share in Note 2m to the consolidated financial statements.

2. In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an Amendment of ARB No. 43, Chapter 4." ("SFAS No. 151"). SFAS No. 151 amends Accounting Research Bulletin ("ARB".) No. 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight handling costs and wasted materials (spoilage) should be recognized as current-period charges. In addition, SFAS No.151 requires that the allocation of fixed production overhead to the costs of conversion should be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after September 15, 2005. As of December 31, 2005, the Company does not expect that the adoption of SFAS No. 151 will have a material effect on its financial position or results of operations.

3. In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS No. 154"), a replacement of APB No. 20, "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements". SFAS No. 154 provides guidance on acounting for and the reporting of accounting changes and error corrections. APB No. 20 previously required that most voluntary changes in accounting principles be recognized by including the cumulative effect of changing to the new accounting principle, in net income for the period of change. SFAS No. 154 requires retroactive application to prior periods' financial statements of a voluntary change in accounting principles unless it is impracticable. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 14, 2005. As of December 31, 2005, the Company does not expect that the adoption of SFAS No. 154 will have a material effect on its financial position or results of operations.

3 Marketable Securities

As of December 31, 2005 and 2004, all of the Company's securities are classified as held-to-maturity.

The following is a summary of held-to-maturity securities:

U.S. Dollars in thousands

December 31,	2005				2004			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Market value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Market value
U.S. corporate bonds	17,732	-	(147)	17,585	16,227	22	(55)	16,194

The gross unrealized losses on the Company's investments in U.S. corporate bonds were due to interest rate increases. The Company reviews its investments to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee and the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

As of December 31, 2005, management believes that no gross unrealized loss represents other-than-temporary impairment.

The amortized cost and estimated fair value of marketable equity securities as of December 31, 2005 and 2004 by contractual maturity, are as follows:

U.S. Dollars in thousands

December 31,	2005				2004			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Market value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Market value
Due in one year or less	9,227	-	(70)	9,157	7,992	22	(3)	8,011
Due in one to two years	8,505	-	(77)	8,428	5,735	-	(38)	5,697
Due in two to three years	-	-	-	-	2,500	-	(14)	2,486
	17,732	-	(147)	17,585	16,227	22	(55)	16,194

4 Other accounts receivable and prepaid expenses

U.S. Dollars in thousands

December 31,	2005	2004
Government grants and participation	158	398
Government authorities	673	528
Accrued interest	146	159
Prepaid expenses	348	195
Other accounts receivable	138	177
	1,463	1,457

Notes to Consolidated Financial Statements

5 Inventories

U.S. Dollars in thousands

December 31,	2005	2004
Raw materials	1,305	1,684
Work in progress	440	852
Finished products	717	664
	2,462	3,200

6 Property and equipment

U.S. Dollars in thousands

December 31,	2005	2004
Cost:		
Computers and peripheral equipment	1,348	1,295
Machinery and equipment	325	319
Office furniture and equipment	166	157
Leasehold improvements	113	113
	1,952	1,884
Accumulated depreciation:		
Computers and peripheral equipment	1,048	969
Machinery and equipment	224	201
Office furniture and equipment	72	62
Leasehold improvements	75	64
	1,419	1,296
Depreciated cost	533	588

Depreciation expense for the years ended December 31, 2005, 2004 and 2003 was $ 215, $ 263 and $ 319, respectively.

During 2005 and 2004, the Company recorded a reduction of approximately $92 and $ 603, respectively, to the cost and accumulated depreciation of fully depreciated equipment no longer in use, following an assessment made by the Company.

For liens, see Note 8d.

Notes to Consolidated Financial Statements

7 Accrued expenses and other liabilities

U.S. Dollars in thousands

December 31,	2005	2004
Provision for warranty costs	548	364
Government authorities	528	836
Accrued expenses and other liabilities	1,655	1,344
	2,731	2,544

8 Commitments and contingent liabilities

a. Lease commitments:

The Company and its subsidiaries lease office facilities and motor vehicles, under operating leases, for periods ending in 2008.

Future minimum lease commitments (including options periods) under non-cancelable operating leases as of December 31, 2005, are as follows:

U.S. Dollars in thousands

Year	Lease commitment
2006	704
2007	233
2008	101
	1,038

Total lease expense for the years ended December 31, 2005, 2004 and 2003 amounted to \$ 900, \$ 889 and \$ 893, respectively.

b. Guarantees:

As of December 31, 2005, the Company is contingently liable in respect of bank guarantees in favor of a lessor totaling \$ 72.

c. Royalty commitments:

The Company is committed to pay royalties to the Chief Scientist of Israel's Ministry of Industry and Trade at a rate of 3% of all revenues from the sales of products and services, that are developed with the assistance of the Chief Scientist by way of grants.

The total royalties that the Company will be obligated to pay will not exceed 100% of the amount of the grant. The royalties bear interest at the applicable LIBOR rate at the time the grants were received.

As of December 31, 2005, the Company has a contingent obligation to pay royalties in respect of the aforementioned grants in the approximate amount of \$ 3,900.

d. Liens:

To secure its line of credit and loans from banks, the Company has recorded a fixed lien on its share capital, goodwill, notes and other documents, property and equipment.

Notes to Consolidated Financial Statements

9 Income taxes

a. General

The Company operates within multiple taxing jurisdictions (primarily in Israel) and is subject to an audit in those jurisdictions. These audits can involve complex issues, which may require an extended period of time to resolve. In management's opinion, adequate provisions for income taxes have been made.

b. Israel taxation

1. Corporate tax structure:

Until December 31, 2003, the regular tax rate applicable to income of companies (which are not entitled to "approved enterprise" benefits, as described below) was 36%. Per the amendments to the Income Tax Ordinance (number 140 and 147), the corporate tax rate is progerssively reduced as follows: 2004 - 35%, 2005 - 34%, 2006 - 31%, 2007 - 29%, 2008 - 27%, 2009 - 26%, 2010 and thereafter - 25%.

2. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the "Law"):

Substantially all of the Company's production facilities have been granted status as an "Approved Enterprise", under the Law, in three investment programs.

The Company has chosen "the alternative benefits" track provided by the Law. Accordingly, the Company's income attributed to the "Approved Enterprise" is tax exempt for a period of two years and is subject to a reduced corporate tax rate of 10% - 25% for an additional period of five to eight years, based on the percentage of foreign investment in the Company. The benefit period has not yet commenced.

The period of tax benefits begins on the year in which taxable income is first earned and except for the two years of tax exemption, is limited to the earlier of 12 years from the year of commencement of production, or 14 years from the date of approval.

The entitlement to the above benefits is conditioned by the Company's fulfillment of the conditions stipulated by the above Law, regulations published thereunder and the letters of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be cancelled and the Company may be required to refund the amount of the benefits, in whole or in part, linked to the Israeli Consumers Price Index (“CPI”) and including interest.

The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without subjecting the Company to taxes only upon the complete liquidation of the Company. If the retained tax-exempt income is distributed in a manner other than in the complete liquidation of the Company, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative benefits track (currently - 10%-25%). The Company’s Board of Directors has determined that such tax exempt income will not be distributed as dividends.

Should the Company derive income from sources other than the "Approved Enterprise" during the periods of benefits, such income shall be taxable at the regular corporate tax rate.

9 Income taxes (Cont.)

The Investment Law was significantly amended on April 1, 2005, ("the Amendment"). The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a Beneficiary Enterprise, including provisions requiring that at least 25% of the Beneficiary Enterprise's income will be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits.

However, the Investment Law provides that terms and benefits included in certificates of approval previously granted will remain subject to the provisions of the Law, as they were on the date of such approval. Therefore the existing Approved Enterprise will generally not be subject to the provisions of the Amendment. As a result of the amendment, tax-exempt income generated under the provisions of the new Law will subject the Company to taxes upon distribution or liquidation and the Company may be required to record deferred tax liability with respect to such tax-exempt income. As of December 31, 2005, the Company did not generate income subject to the provision of the new Law.

3. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985 ("the Israeli law"): Under the Israeli law, results for tax purposes are measured in accordance with the changes in the Consumers Price Index (”CPI”), or in the exchange rate of the dollar for a "foreign investors company". Until 2002, results for tax purposes were measured in terms of earnings in NIS after certain adjustments for increases in the CPI. Beginning January 1, 2003, the basis for remeasurment is the changes in the exchange rate of the dollar.

c. Carryforward tax losses:

As of December 31, 2005, the Company had approximately $ 4,000 of Israeli carryforward tax losses, which may be carried forward and offset against taxable income in the future for an indefinite period.

As of December 31, 2005, the U.S. subsidiary had U.S. federal carryforward tax losses of approximately $ 3,500 that can be carried forward and offset against taxable income for 15-20 years and expire from 2011-2022.

d. Final tax assessments:

A.V.T. has received final tax assessments through 2004.

e. Deferred income taxes:

Significant components of the deferred tax assets of the Company are as follows:

U.S. Dollars in thousands

December 31,	2005	2004
Deferred tax assets:		
Net operating loss carryforwards	2,919	3,902
Reserves and allowances not currently deductible	513	315
Net deferred tax asset before valuation allowance	3,432	4,217
Valuation allowance	(3,095)	(4,217)
Net deferred tax assets	337	-

9 Income taxes (Cont.)

The Company provided a valuation allowance for all periods presented except for 2005 as the applicable tax rate, through out the period, in which the Company will utilize its carryforward losses, is expected to be 0%, due to the "Approved Enterprise" status (see b above). In 2005, a portion of the Company's carryforward losses were deferred by the income tax authorities to future years in which the tax rate will exceed 0%. The Company recorded a tax asset in connection with those losses.

f. Reconciliation of the theoretical tax expense:

U.S. Dollars in thousands

Year Ended December 31,	2005	2004	2003
Income before taxes on income	4,029	2,402	765
Statutory tax rate	34%	35%	36%
Theoretical tax at statutory tax rate	1,370	841	275
Increase (decrease) in respect of:			
Losses, reserves and allowances for which valuation			
allowance was provided	24	161	952
Utilization of carryforwards losses for which valuation			
allowance was provided in prior years	(1,064)	(119)	-
Tax adjustment in respect of "Approved Enterprise" status	(566)	(748)	(1,014)
Non-deductible expenses	64	64	58
Actual tax expense (benefit)	(172)	199	271

g. Income before taxes on income consists of the following:

U.S. Dollars in thousands

Year Ended December 31,	2005	2004	2003
Domestic	1,430	3,014	2,162
Foreign	2,599	(612)	(1,397)
	4,029	2,402	765

10 Share capital

a. On March 17, 2003, the Company announced that its Board of Directors has decided to make a tender offer to all shareholders and holders of vested options to acquire up to one third of all shares, pro rata to the respective share of the shareholders and option holders, at a price of $ 8 per share. As a result of the tender offer, the Company purchased 1,890,752 shares at a cost of $ 15,933. In September 2005, the Company sold 8,000 treasury shares at $ 85, in order to comply with certain requirements of the Law for the Encouragement of Capital Investments, 1959. As of December 31, 2005, the Company is holding 1,882,752 treasury shares.

10 Share capital (Cont.)

b. The Company's options held as of December 31, 2005 by the following members of the Board of Directors of the Company, are as follows:

Name	Number of stock options held	Number of shares held
Executive Managment		
Shlomo Amir	145,000	82,575
Danny Danziger	19,250	4,050
Zev Morgenstern	21,250	-
Noam Noy	19,250	-
Koby Shtaierman	19,250	-
Lance Shumaker	22,625	-
Gal Shamri	13,000	-

Name	Number of stock options held	Number of shares held
Board of Directors		
Israel Adir	39,000	23,334
Michael Goldstein	120,250	61,512
Allan Green	15,000	-
Pierre Francois Veil	15,000	-
Michael Sessler	15,000	-
Yona Admon	15,000	-
Itzhak Krinski	15,000	-

c. Repricing:

In June 2002, 815,886 previously granted options with exercise prices ranging between $ 0.5-$ 30.5 were repriced to $ 0, resulting in a new measurement date and total compensation cost of $ 1,588. Stock-based compensation expense resulting from the repricing, for the years ended December 31, 2005, 2004 and 2003 was $ 39, $ 214 and $ 336, respectively.

d. Stock option plans:

Under the 1998 and 2003 Stock Option Plans, the Company is authorized to grant options to purchase Ordinary shares to its employees, directors and consultants. Under the 1999 U.S. Option Plan and the Global Plan, the Company is authorized to grant stock options to employees, officers and consultants of the subsidiaries of the Company. The plans authorize the grant of options to purchase up to 1,846,050 Ordinary shares.

Options granted under the four plans expire ten years from the date of grant or upon termination of the optionee's employment or other relationship with the Company. The options generally vest over a four-year period. Any options that are cancelled or forfeited before expiration become available for future grants.

As of December 31, 2005, there were 501,750 options available for future grants.

10 Share capital (Cont.)

A summary of the stock option activities in 2005, 2004 and 2003, is as follows:

U.S. Dollars in thousands (except share and per share amounts)

Year Ended December 31,	2005		2004		2003	
	Amount	Weighted average exercise price	Amount	Weighted average exercise price	Amount	Weighted average exercise price
Beginning of the year	747,911	5.10	606,329	3.09	936,342	0.11
Granted	34,000	11.74	357,000	6.88	324,500	5.61
Exercised	(64,901)	0.69	(122,834)	0.02	(636,574)	0.31
Forfeited	(35,750)	6.15	(92,584)	5.52	(17,939)	1.32
Outstanding at the end of the year	681,260	5.80	747,911	5.10	606,329	3.09
Exercisable at the end of the year	250,381	4.23	123,284	0.68	190,641	0.03

All options were granted with an exercise price equal to the market value at the date of the grant.

The options outstanding as of December 31, 2005 have been separated into exercise prices as follows:

U.S. Dollars in thousands (except share and per share amounts)

Options outstanding as of December 31, 2005	Exercise price	Weighted average remaining contractual life	Options exercisable as of December 31, 2005
72,676	-	4.402	66,926
2,500	2.12	6.477	1,875
1,334	4.08	3.277	1,334
171,750	4.35	7.382	80,250
30,000	5.77	8.329	10,000
250,000	6.84	8.228	50,000
9,000	6.92	8.099	-
70,000	7.54	7.693	39,996
40,000	8.00	8.849	-
4,000	8.57	9.252	-
30,000	12.16	9.915	-
681,260	5.80	7.655	250,381

10 Share capital (Cont.)

Weighted-average fair values and weighted average exercise prices of options at the date of grant are as follows:

U.S. Dollars in thousands (except share and per share amounts)

	2005	2004	2003	2005	2004	2003
	Weighted average fair values of options on date of grant			Weighted average exercise prices		
Exercise price equal to market value	4.97	3.10	2.89	11.74	6.88	5.61

e. As of December 31, 2005, there are 11,160 options with an exercise price of $ 21 held by a bank. The options are fully vested and exercisable until January 12, 2009.

11 Earnings per share

The following table sets forth the computation of basic and diluted net earnings per share ("EPS"):

U.S. Dollars in thousands (except share and per share amounts)

Year Ended December 31,	2005	2004	2003
Net income	4,201	2,203	494
Weighted average Ordinary shares outstanding -			
Basic EPS	4,370,771	4,306,774	5,067,193
Dilutive effect:			
Employee stock options	291,322	255,540	281,977
Weighted average Ordinary shares outstanding			
- Diluted EPS	4,662,093	4,562,314	5,349,170
Basic net earnings per share	0.96	0.51	0.10
Diluted net earnings per share	0.90	0.48	0.09

The total weighted average number of options excluded from the calculation of diluted net earnings per share, as they would have an anti-dilutive effect were 13,872, 110,092 and 58,400 for the years ended December 31, 2005, 2004 and 2003, respectively.

Notes to Consolidated Financial Statements

12 Segment information

The Company operates in one business segment, see Note 1 for a brief description of the Company's business.

Operations in Israel include research and development, marketing and sales. Operations in the U.S. and Europe include marketing, support and sales. The following is a summary of operations within geographic areas:

U.S. Dollars in thousands

December 31,	2005	2004	2003
Revenues based on the customer's location:			
United States	8,284	4,805	4,274
Europe (other than Germany)	7,282	7,931	6,288
Germany	2,940	2,817	2,382
Other	6,637	5,805	4,320
	25,143	21,358	17,264
Long-lived assets by geographic location:			
Israel	1,253	1,359	1,544
Europe	68	80	50
United States	37	31	42
	1,358	1,470	1,636

13 Selected statements of operations data

a. Restructuring expenses:

During the fourth quarter of 2003, the Company announced a restructuring plan for its German subsidiary, and recorded restructuring charges of $ 83, in accordance with SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities". The Company measured the total termination benefits at the communication date based on the fair value of the liability as of the termination date. As a result of this restructuring plan, six positions were eliminated.

b. Financial income, net:

U.S. Dollars in thousands

Year Ended December 31,	2005	2004	2003
Financial income, net:			
Financial income:			
Interest	686	770	1,122
Foreign currency translation differences, net	-	167	145
	686	937	1,267
Financial expenses:			
Bank charges	83	76	161
Foreign currency translation differences, net	500	-	-
Other	73	200	381
	656	276	542
	30	661	725

Report of the Board of Directors

During 2005 we performed our duties as outlined by the law and according to corporate governance prevailing in the State of Israel. As part of our duties, we have supervised the ongoing conduct of the company's management and were informed, at the Board of Directors meetings, of business development and other material corporate issues related to the company and its subsidiaries.

The Board of Directors consists of eight members including two external Directors. In 2005 two Directors were replaced; the new members bring the added value of new perspectives and experience. During the Board's meetings, the emphasis was on strategies for profitable growth through business development in recovering traditional markets and new emerging markets showing high potential for demand in our industry.

In compliance with the Israel Companies Law, the Board of Directors has an Audit Committee, which consists of three Board members, the two external directors and an additional director who is neither an officer of the company nor the chairman (as required by Israeli Law). The committee is responsible, among other issues, for the review of the financial statements, the accounting standards applicable to the company, and financial presentation of issues subject to management judgment and to compensation issues related to Directors and officers. The Committee is also responsible for the nomination of the company's internal Auditor, the determination of his annual audit plan, review of his final reports and the supervision of his recommendations' implementation. During 2005, we held 9 Board of Directors meetings, 5 Audit Committee meetings and various Board committee meetings during which we discussed these business-related and financial issues. In all Board of Directors meetings we had a legal quorum of more than five attendees and in the Audit Committee we had the attendance of at least the two external Directors.

The management of the company prepared the annual consolidated Financial Statements in accordance with US GAAP. The consolidated balance sheets of the company and its subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005,were audited by KOST FORER GABBAY & KASIERER, a member of Ernst & Young Global.

In the Audit Committee and Board of Directors meetings held on January 30th, 2006, attended by the company's auditors and legal counsel, we discussed the 2005 Financial Statements and resolved to approve the Annual Report. We have further resolved to present the Financial Statements for review and discussion at the Annual General Meeting of Shareholders.

Hod Hasharon, March 20, 2006

Michael Goldstein
Chairman

Members of the Board of Directors

Michael Goldstein, Chairman

Mr. Goldstein co-founded AVT in 1992. He is also a co-founder of DMA-TEK, which produces electronic wristlets for home arrests and is traded on the AIM London Stock Exchange (DTK. L).
Formerly, he was product line manager in the Advanced Development Center of Elron, an Israeli technology company, where he developed machine-vision based inspection systems for the metal industry. He serves as director of several high-tech companies and has published numerous articles and been granted numerous patents in the field of machine vision. Mr. Goldstein holds a B.Sc. in Physics and an M.Sc. in Engineering from Tel Aviv University, Israel.

Pierre-Francois Veil

Mr. Veil is a lawyer from Paris and one of the founders of the firm Dubarry Le Douarin Veil. His specialization is corporate law, mergers & acquisitions as well as international law. He studied at the renowned Institute D´Etudes Politiques in Paris and holds a degree from the University of Paris. Mr. Veil is a member of several legal associations and of the International Bar Association.

Allan Green

Mr. Green was born in Canada but feels at home in international business across the world. His own company, Candel & Partners, France, specializes in national and international merger & acquisition transactions. C&P had held an interest in AVT long before its initial public offering.

Yona Admon

Ms. Admon is extensively engaged in financial consulting for both private and public companies, and has broad experience in Venture Capital. She was formerly the CFO of Zinger Barnea, Dovrat Shrem, Clal Development and Rada Electronics.
Yona now serves as an Independent Director of Maalot-The Israel Securities Rating Company and a board member of the rating committee. She is also an Independent Director of "Lehava"-Continuing Educational Fund and an External Director of Elrov (a Public Company). Ms. Admon holds a BA in Accounting and Economics and an MBA from The Hebrew University, Jerusalem, Israel.

Dr. Itzhak Krinsky

Dr. Itzhak Krinsky is Vice President Business Development of Teva Pharmaceutical Industries Ltd. He has over 25 years of senior financial and business management experience. In addition to extensive Mergers & Acquisitions involvement on Wall Street in transaction origination, execution, idea and strategy development, Dr. Krinsky has substantial finance and economics expertise, having served as Professor of Finance and Business Economics at McMaster University, Canada. Prior to joining Teva, Dr. Krinsky was a Managing Director in the Mergers and Acquisitions group and a member of the Technology M&A and M&A Strategies Teams at Deutsche Bank in New York. Dr. Krinsky earned his B.A. and M.A. from Tel Aviv University and his Ph.D. from McMaster University, Canada.

Dr. Michael Sessler

Dr. Sessler Graduated Medical School in 1989 and serves as a member of the management board of Electra Consumer Products Ltd. Electra is a globally active company with headquarters in Israel where it is listed on the stock exchange. Dr. Sessler is a member of the Board of foreign companies as well as Electra Ltd. in Israel, and has extensive experience in and knowledge of the implementation of strategies and business processes in globally active companies.

Israel Adir

Mr. Adir joined the Company in 1995. He is founder and chairman of the boards of directors of the companiesin the RDT Group, a sales organization and solution provider to the Israel high-tech industry. Mr. Adir is the ex-commander of the Electronics School of the Israeli Air Force and is a member of the board of directors of the Israeli Chamber of Commerce. He is chairman of the Electronic Representatives Association and has made investments in, and successful exits from, numerous high-tech start-ups in Israel. Mr. Adir holds a degree in Electronic Engineering from the Technion - Israel Institute of Technology, Haifa, Israel.

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