

AVT Annual Report 2006



Advanced Vision Technology Ltd.

Financial Highlights

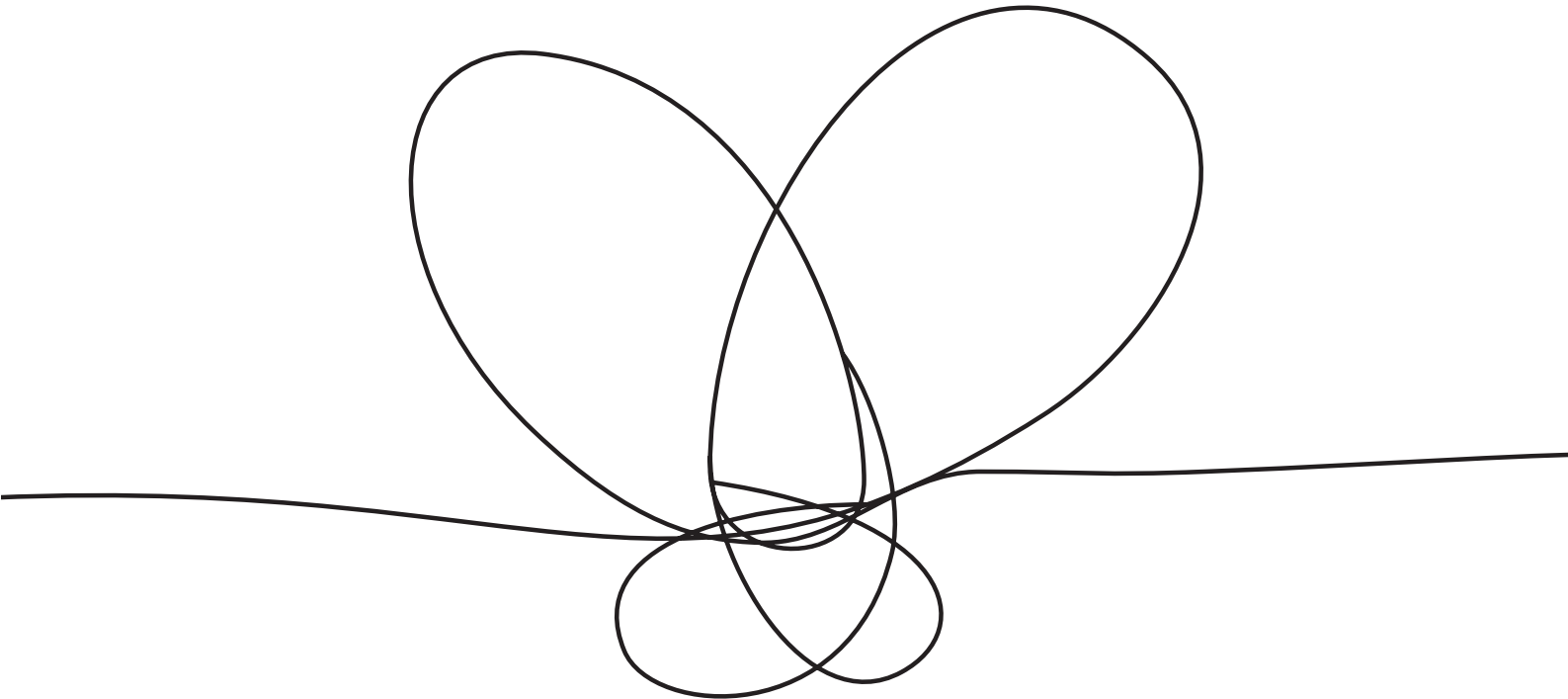
US dollars in thousands (except per share amounts)

Year ended December 31,	2006	2005	2004
Revenues and Income			
Revenues	28,469	25,143	21,358
Gross profit	17,630	15,474	13,086
Gross margin in %	61.93%	61.54%	61.27%
Research and Development expenses, net	3,492	3,005	2,698
Sales and Marketing expenses, net	6,605	6,009	6,485
General and Administration expenses	3,018	2,422	1,948
Amortization of deferred stock-based compensation	582	39	214
Operating profit	4,515	3,999	1,741
Operating margin in %	15.86%	15.91%	8.15%
Net income	5,414	4,201	2,203
Cash flows provided by operating activities	6,209	4,451	1,335
Cash flows provided by (used in) investing activities	7,835	-1,716	-3,150
Cash flows provided by financing activities	482	130	3
Balance sheet as of December 31,			
Cash and Equivalents	22,227	7,701	4,836
Total assets	44,385	36,669	31,795
Total liabilities	9,120	7,908	7,404
Total shareholders' equity	35,265	28,761	24,391
Share			
Basic earnings per share in USD	1.20	0.96	0.51
Share price as of December 31,	11.80 Euro	9.60 Euro	7.10 Euro
Employees			
Employees as of December 31,	123	109	110

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The Power of Partnership



Dear Shareholders,

I am proud to report 20 consecutive quarters of revenue growth, bringing AVT to the end of 2006 with record results. We continue to strengthen our dominant position in automatic print inspection of the global packaging and label web-printing markets. At the same time, we spread our own web wider, entrenching our position in growing markets such as China and Eastern Europe.

In the web-printed packaging and label industries, AVT holds a 60% market share in the US and Europe. 50% of our sales are repeat sales, to a growing, loyal customer base. Since less than 10% of the world's packaging and label printers utilize machine vision for print inspection - mostly due to adherence to traditional practices - our potential for growth is still tremendous.

Facts and Figures

In 2006, AVT revenues grew by 13.2%, to \$28.5 million, with net profits reaching \$5.4 million for the year. Revenues for the fourth quarter were \$7.4 million – an increase of 12.3% over the same period in 2005. Order bookings for 2006 were over \$28.9 million – an increase of 10.5% over the same period last year. Our order backlog at year-end was \$9.4 million.

Beyond excellent sales, our service revenues also continue to grow, as the installed base expands. Service revenues for 2006 totalled \$2 million – an increase of 48.8% over the previous year.

Partnerships that set our ships sailing further

As leaders in our market, we often single-handedly blaze the trail which takes us forward. But just as often, and increasingly during this past year, we have found great latitude in seeking and accepting opportunities for partnership. It is this *Leadership through Partnership*, as was so succinctly defined in the theme of the Label Expo Americas 2006 trade show in Chicago, that we proudly bring forth this year. No less than eight different booths throughout the show floor at Label Expo featured AVT solutions, running on presses and rewinders, demonstrated by our OEM partners.

Closely cooperating with leading press and rewinder manufacturers, AVT has developed and fully integrated its automatic inspection and quality assurance solutions into printing equipment. The resulting integrated systems enhance product quality and production efficiency throughout the complete label converting process. AVT is committed to an intensive, continuing dialogue with printers and press and rewinder manufacturers, to bring new benefits to this market.

Other forms of cooperation have yielded additional commercial fruit: Installing a product like Presco, AVT's unique technology for automatic plate and anilox pressure pre-setting and control, has become a critical factor in enabling many wide-web press manufacturers to compete in the packaging market. The crucial necessity to cut set-up time and minimize material waste has created a very close bond and fruitful cooperation between AVT and these press manufacturers.

During the course of the year we participated in Open House events of our partners across the globe, presenting our solutions integrated with their equipment to a select crowd of targeted customers. This is an excellent route for reaching a captive audience, and has indeed brought us many new business leads.

Evolution

With an installed base of over 1,500 systems in the web-fed packaging market, AVT quickly achieved dominance in the label printing market it entered only two years ago. Sheet-fed print applications are the natural next step. In 2006 we made our strategic entrance into the sheet-fed printing market.

The worldwide sheet-fed press market is estimated at more than 370,000 machines. Approximately 20,000 sheet-fed presses and 10,000 folders/glueers are serving the packaging, labels and security printing applications. Due to this great potential, we have adapted our market-leading web-fed print inspection technology to meet the requirements of the sheet-fed print market. The first AVT sheet print inspection installation at the French security printer Cartor, one of the major stamp converters in Europe, was extremely successful. We intend to continue introducing a variety of solutions for the sheet-fed print market in the next 12 months.

In the coming year we also intend to enter the single-pack and blank inspection market, within the folding carton segment of the packaging industry.

Revolution

A brand new and exciting field under development in our R&D labs is inspection of printed electronics. In our continuous search for applicable fields for our unique technologies, we have identified the promising area of RFID tags manufacturing, and began developing solutions for automatic inspection of printed electronics. When this new approach to electronic circuit manufacturing becomes a reality – AVT will be well positioned as the leader in its automatic inspection.

We look forward to the exciting opportunities ahead. As always, we remain indebted to you, our dedicated shareholders, and to our committed employees and loyal customers. Thank you.

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 Corporation 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

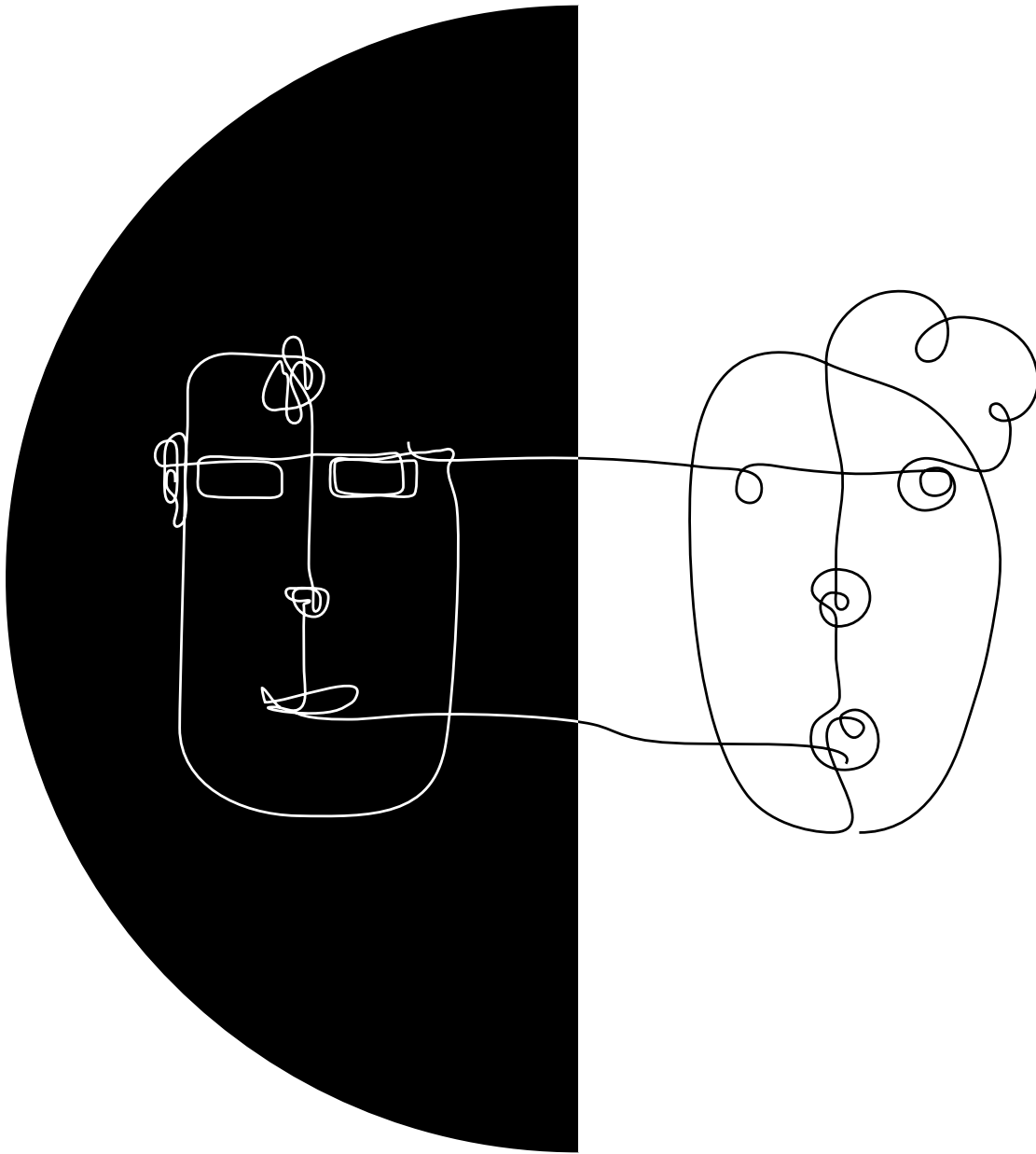
Prior to joining AVT in 2001, Mr. Danziger served for five years at the Davidoff Group, an Israel-based international company in the area of insurance and medical services. He held various positions, including CEO of Femi Medical Services Ltd., and later CEO of the Davidoff Group. Previously Mr. Danziger 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. 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, both in Israel.

Lance Shumaker, President, AVT Inc.

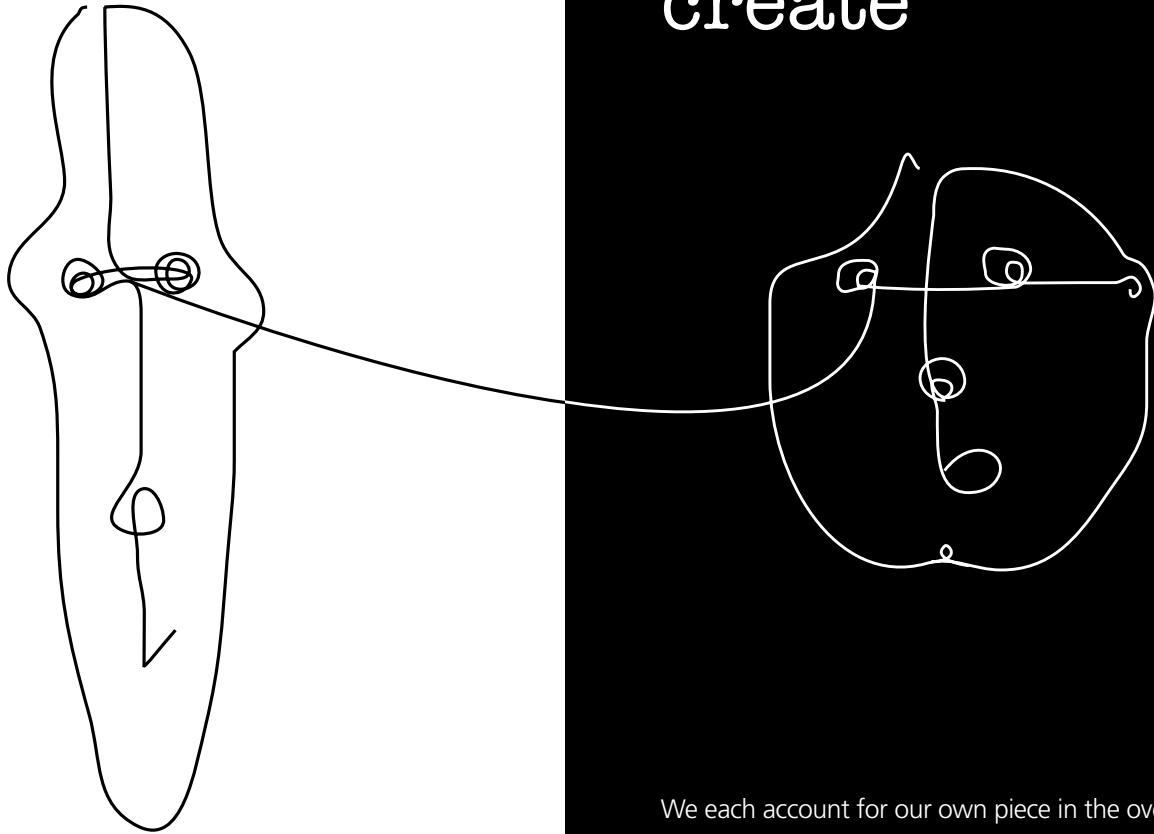
Mr. Shumaker joined AVT in 1998. Before joining AVT, Mr. Shumaker held various positions in the graphic arts market, including: director of sales for Indigo America, an Israel-based international high-tech company in the field of digital printing, and national accounts manager for Scitex America Corporation, 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.



The Power of Partnership

One line runs through most great creations: one stroke of a brush from which a masterpiece painting evolves; one magical tune running through a timeless song; one perfect print run, enabled by automatic, early detection of errors. It takes clarity and vision to connect separate innovative efforts, and leverage the power of partnership toward a joint creative achievement. Since its inception, AVT has been drawing lines together with its customers and strategic partners, benefiting from the power embedded in cooperation. As we apply careful coordination, deep thought and joint resources, the power of partnership keeps leading us ahead, leap by leap.

Inspiring each other to create

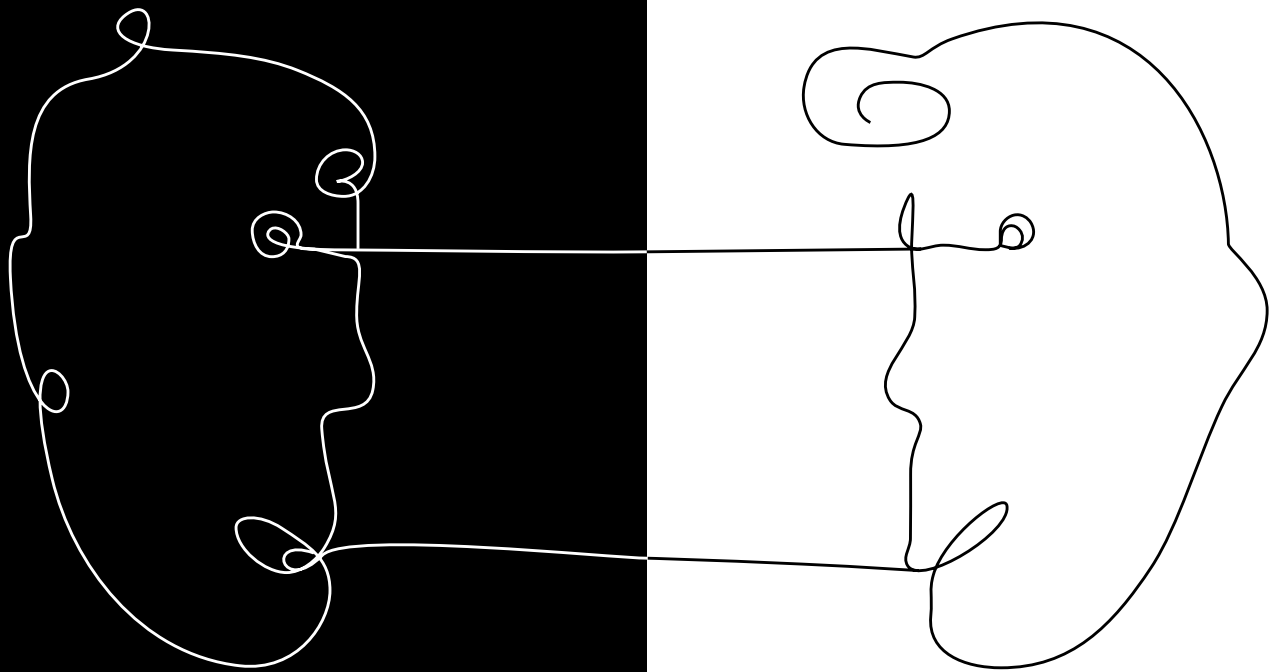


We each account for our own piece in the overall puzzle, but we look each other in the eye at a certain angle, and that spark of inspiration can be seen miles away. At AVT we cherish our OEM partners, whom we join in the creative endeavor, to make that power of partnership work wonders. AVT cooperates with leading press and rewinder manufacturers, and fully integrates its automatic inspection solutions into printing and converting equipment. The integrated systems dramatically enhance product quality and production efficiency throughout the packaging and label converting process, bringing great benefits to these markets.

A unique example of a product of close cooperation with an OEM partner is Presco, our automatic plate and anilox pressure pre-setting and control system. Presco has enabled our wide-web press manufacturer partners to improve their products dramatically, and to better serve the packaging market. Together, we continue to develop new products for that market.

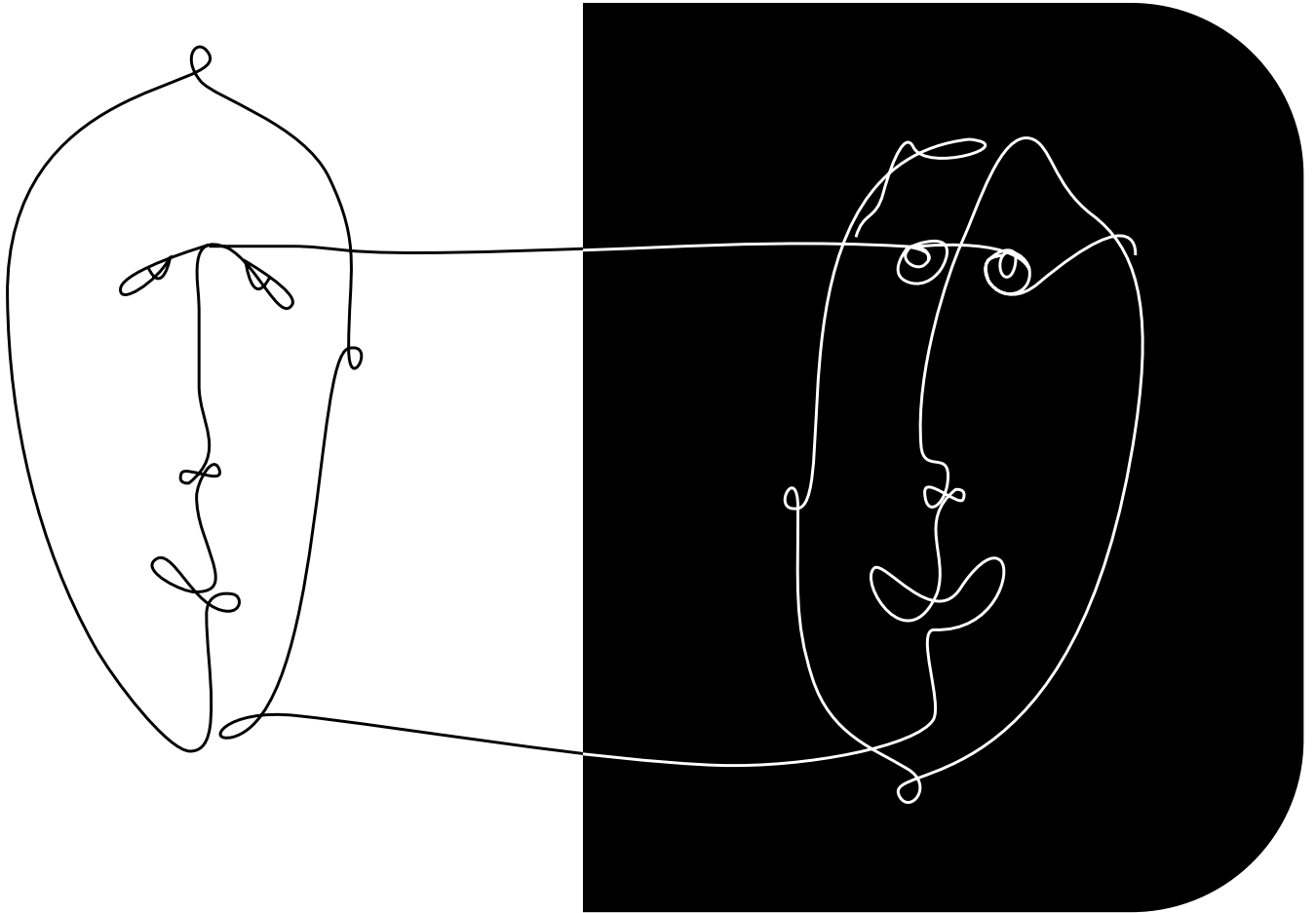
**The power of partnership.
mutual inspiration.**

Reading between the lines



The art of R&D lies between the lines that are there for everyone else to see. AVT is always in search of new applications for our unique technologies, such as the new and exciting field of printed electronics. Our partners introduced us to the promising area of RFID tags manufacturing, and we immediately began developing solutions for automatic inspection of printed electronics. When this new approach to electronic circuit manufacturing becomes a reality – AVT will be well positioned as the leader in its automatic inspection. This is how reading between the lines can put us at the top of the page, and right on the front cover.

**The power of partnership.
extended brain power.**

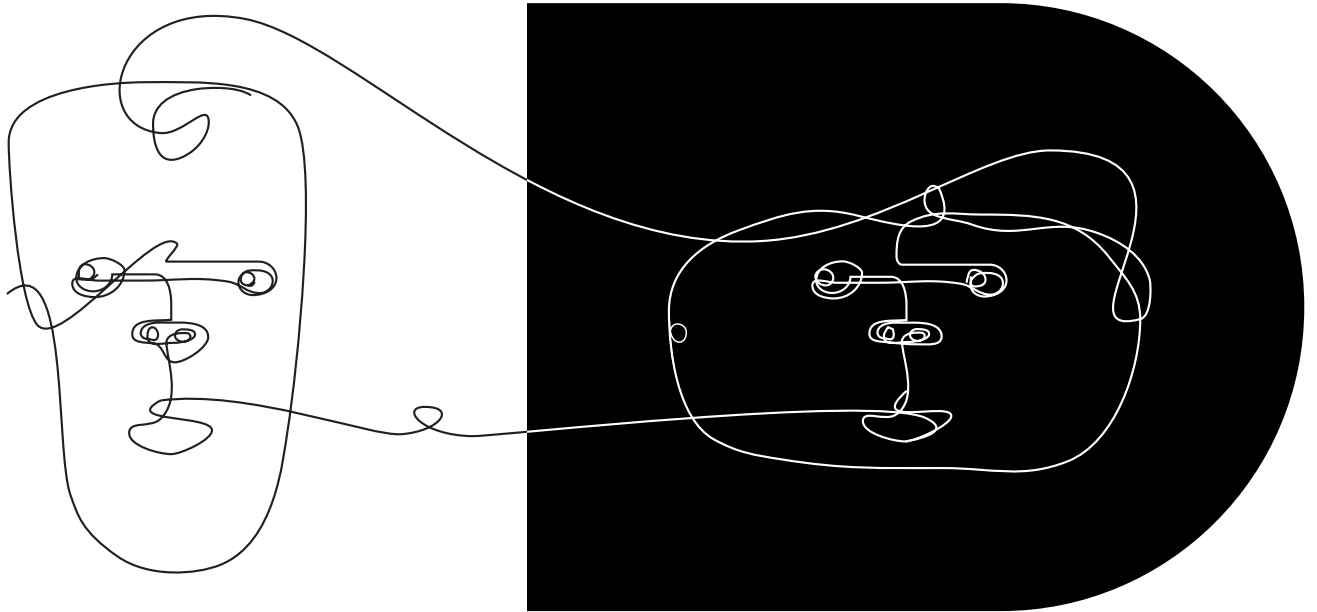


Growing together

Customers' needs are what got AVT started in the first place. Their insightful comments perfected our initial product. Our company was founded on the basis of a real partnership with its customers, and it has grown upon continued cooperation with them ever since. At AVT we value our customers deeply, and help each other as we grow in years and in profits. They keep their business with us, and we keep learning from them.

**The power of partnership.
mutual support.**

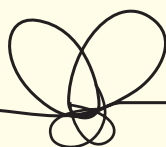
Opening up opportunities



Unfinished lines are open opportunities. So is another set of eyes facing your own. An Open House is a wide open business opportunity. One in which you encounter many eyes facing your product. AVT has been invited to several Open House events this past year, all over the world, where we presented our solutions integrated with our OEM partners' equipment. These exclusive events, to which a select group of customers is invited, are an excellent exposure opportunity for AVT.

**The power of partnership.
extending horizons.**

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 and 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 and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statement, 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 - the quality assurance solution for the packaging industry.

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.

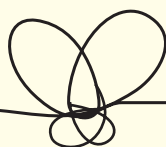
In 2004 we introduced the full workflow support and the business management-related solutions, which are practical proofs of our commitment to supporting the growing quality needs and cost reduction of the printing industry. The new solutions for efficient and profitable quality control include among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

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

In the second half of 2006 we introduced the quality assurance solution for the sheet fed industry. This is the first of a set of solutions we intend to launch to the sheet-fed print market during the next year.

We established AVT Inc. in October 1996 to serve as our direct distribution channel in the Americas.

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



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 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 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, 2006 approximately 1,500 PrintVision platforms were installed worldwide. No distributor or end-user accounted for more than 10% of revenues in 2006 and 2005.

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 2006 the European currency increased in value relative to the US Dollar by over 11.3%. In Israel, during 2006, the New Israel Shekel ("NIS") increased in value relative to the US Dollar by approximately 8.2%.

Off-Balance Sheet Transactions

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

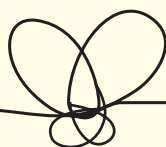
Information on the Company

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 in 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 that offer support to our customers and distributors. These service engineers, as well as additional service engineers located in our subsidiaries in the Americas 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. Generally, our customer support engineer installs and checks the system. As part of the installation procedure, we provide system

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



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, whether contained in optional features or forming an integral part of the functioning capacity of the system, is licensed. 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 to devote 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.

Marketing and Selling. We market our products for automatic inspection of printed materials and provide 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

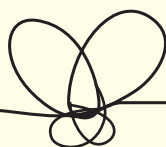
Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States ("US GAAP"). While all the accounting policies impact the financial 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

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



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 delivered; 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 was 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-off may be required and would be reflected in cost of sales in the period the revision is made.

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 there are signals that the asset has experienced a decline in value that is other than temporary. Based on our evaluation, during 2006 we did not record any impairment charge related to our long-lived assets. As of December 31, 2006, the carrying value of our long-lived asset was \$1,475 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.

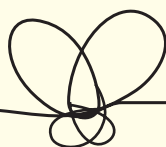
During the fourth quarter of 2006 we performed our annual impairment test of acquired intangible assets as prescribed by SFAS No. 142. This evaluation indicated that an impairment loss does not exist.

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, 2006 we had \$825 thousand of non-amortized goodwill.

Taxes on Income. Taxes on income are calculated based on our assumptions as to our entitlement to various benefits under the Approved Enterprise Law. Our 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

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



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 in the valuation allowance, changes in 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 most 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.

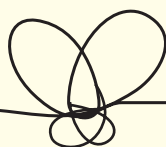
Impact of Inflation and Exchange risk

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,	2006	2005	2004
Inflation (deflation)	(0.1%)	2.5%	1.2%
Devaluation (Revaluation)	(8.2%)	(7.5%)	(1.6%)
Inflation (devaluation) gap	8.1%	10.0%	2.8%

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

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



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.

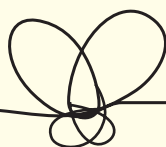
Operating Results

The following table sets forth selected consolidated income statements data for each of the three years ended December 31, 2006, 2005 and 2004 expressed as a percentage of total revenues:

Year Ended December 31,	2006	2005	2004
Revenues	100%	100%	100%
Products	92.8	94.5	94.7
Services	7.2	5.5	5.3
Cost of revenues	38.1	38.5	38.8
Gross profit	61.9	61.5	61.2
Operating expenses			
Research and development, gross	13.4	13.2	15.6
Grants and participations	(1.1)	(1.2)	(2.9)
Selling and marketing	23.2	23.9	30.6
General and administrative	10.6	9.7	9.7
Total operating expenses	46.1	45.6	53.1
Operating income	15.8	15.9	8.1
Financial income, net	4.4	0.1	3.1
Profit before taxes on income	20.2	16.0	11.2
Taxes on income (tax benefit)	1.2	(0.7)	0.9
Net income	19.0	16.7	10.3

Based on SFAS 123R share based payments were recorded as expense at their fair value commencing January 1, 2006. We applied the Modified Prospective without restatement (MPA) method and recorded previous unvested awards measured according to SFAS 123 and awards granted after November 2005 measured according to SFAS 123R. The

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



measurement of the benefit from all new awards is based on the Monte Carlo simulation.

The following table sets forth selected proforma consolidated income statements data (excluding stock-based compensation expense) for each of the years ended December 31, 2006, 2005 and 2004 in thousands US Dollars:

Year Ended December 31,	2006		2005		2004
	GAAP	Stock-based compensation	Non GAAP	Non GAAP	Non GAAP
Revenues	28,469		28,469	25,143	21,358
Cost of revenues	10,839	51	10,788	9,669	8,272
Gross profit	17,630	51	17,681	15,474	13,086
Gross margin	61.9%		62.1%	61.5%	61.3%
Operating expenses					
Research and development, net	3,492	53	3,439	3,005	2,698
Selling and marketing	6,605	102	6,503	6,009	6,485
General and administrative	3,018	376	2,642	2,422	1,948
Total operating expenses	13,115	531	12,584	11,436	11,131
Operating income	4,515	582	5,097	4,038	1,955
Financial income, net	1,231		1,231	30	661
Profit before taxes on income	5,746	582	6,328	4,068	2,616
Taxes on income (tax benefit)	332		332	(172)	199
Net income	5,414	582	5,996	4,240	2,417

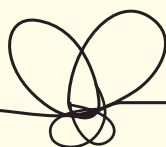
Year ended December 31, 2006, compared with year ended December 31, 2005

2006 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 success and 2006 achievements and looking forward to continue this growth trend into 2007.

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.

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

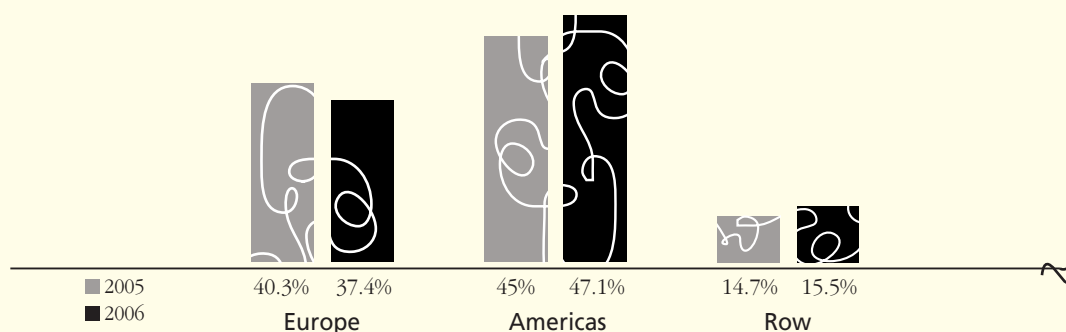


Revenues in 2006 totaled \$28,469 thousand representing an increase of 13.2% over the revenues of 2005. The 2006 revenues constitute a track record and are the highest ever recorded by us. The increase in Revenues is attributable to the good market conditions we have experienced in the US and Europe, and the expansion in Latin America, China and other Asian markets. During 2006 we continued the penetration into the Labels market. Revenues from our labels products accounted for approximately 27% of our annual revenues compared with 20% of revenues in 2005.

Revenues from services are generated from maintenance, training and support fees. We recognize revenues over the contractual period or as services are performed. Service revenues in 2006 totaled \$2,045 thousand (out of the total revenues of \$28,469 thousand) 48.8% higher than the \$1,374 thousand generated in 2005. The increase of service revenues is attributable to the continued increase in the number of Service contracts signed during the year. Service orders received during 2006 were \$2,443 thousand 56.4% higher than in 2005. The service orders, not yet recognized as revenues, will be recognized ratably over the contractual period.

During 2006 order booking totaled \$28,858 thousand representing an increase of 10.5% over 2005 order booking of \$26,119 thousand. The ratio of order booking to revenues in 2006 was 101% demonstrating our growth and improved visibility. As of December 31, 2006 order back-log totaled \$9,388 thousand an increase of 7.3% over the balance at December 31, 2005, 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 2007, while the remainder will become revenue in the proceeding 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.

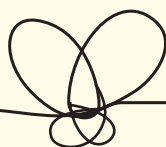
The following chart sets forth breakdown of revenues by territory for each of the two years ended December 31, 2006 and 2005



Cost of Revenues / Gross Profit

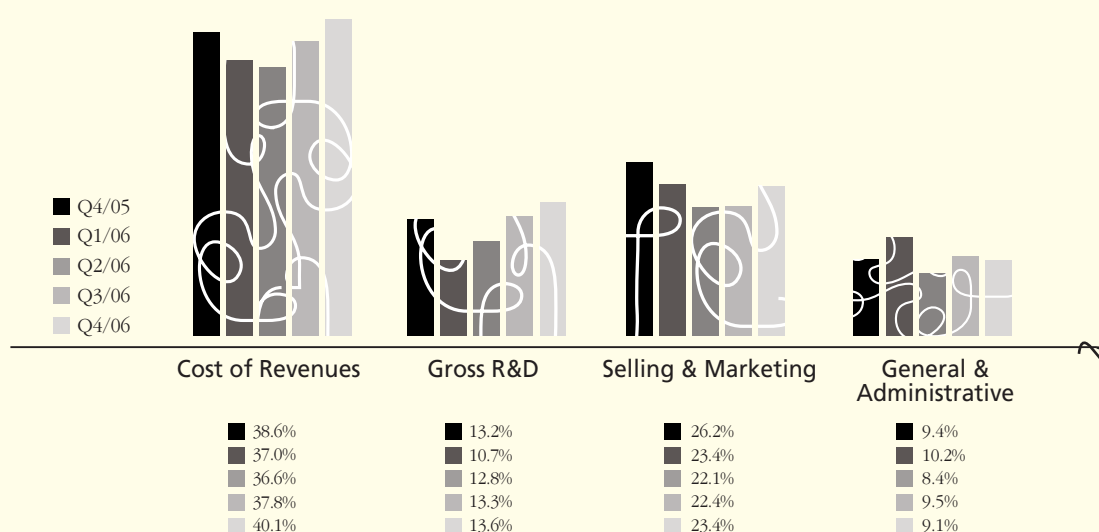
Cost of revenues includes materials, labor, and an estimate of costs associated with installation, warranty and training. We generally provide a one-year warranty to the end-user. A provision, based on our experience and engineering estimates, is recorded to cover probable costs in connection with such warranty, for the 12 months period commencing at the end of installation.

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



In 2006 Gross Margin increased slightly, to 61.9%, up from 61.5% in 2005. While Gross Profit is usually in the range of 61%-62%, minor fluctuations are expected as a result of product mix. Software options are generally increasing the platform's selling price while keeping the same bill of material cost, and consequently improving the Gross Profit. During the first three quarters of 2006 we recorded a reduction in the rate of royalties due to the Office of the Chief Scientist from 3.5% to 3.0%. At year end, the Office of the Chief Scientist, announced that the contemplated reduction has been revised and that it will not be applicable to grants received prior to 2007. This change had no material impact on our annual results.

The following table sets forth selected proforma consolidated expenditures data (excluding stock-based compensation expense) for each of the five quarters ended 31.12.2005, 31.3.2006, 30.6.2006, 30.9.2006 and 31.12.2006 expressed as a percentage of total revenues.



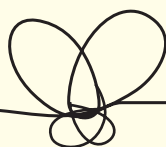
The cost of revenues recorded in Q4 2006 included the reversal of the reduction in royalties due to the Office of the Chief Scientist, recorded in the first three quarters of 2006. The adjusted cost of revenues, as percentage of revenues, excluding the reduction in royalties due, from 3.5% to 3.0%, should have been as follows:

Q1 2006- 37.5%; Q2 2006 - 37.1%; Q3 2006 - 38.3%; Q4 2006 - 38.7%.

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. In 2006, gross research and development expenses totaled \$3,808 thousand, 14.8% higher than 2005 (\$3,317 thousand). This increase is primarily attributable to the development of solutions to the sheet fed market. R&D expenses were partially offset by certain government grants and participations. In 2006, total government grants and participations due were \$316 thousand compared with \$312 thousand received for 2005. The funds available for Office of the Chief

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



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 2006, selling and marketing expenses increased by 9.7% compared to 2005. The increase is attributable to the increase in selling and marketing activities during the year. Pro forma expenses (excluding stock-based compensation expense) increased during 2006 by 8.2% compared with 2005.

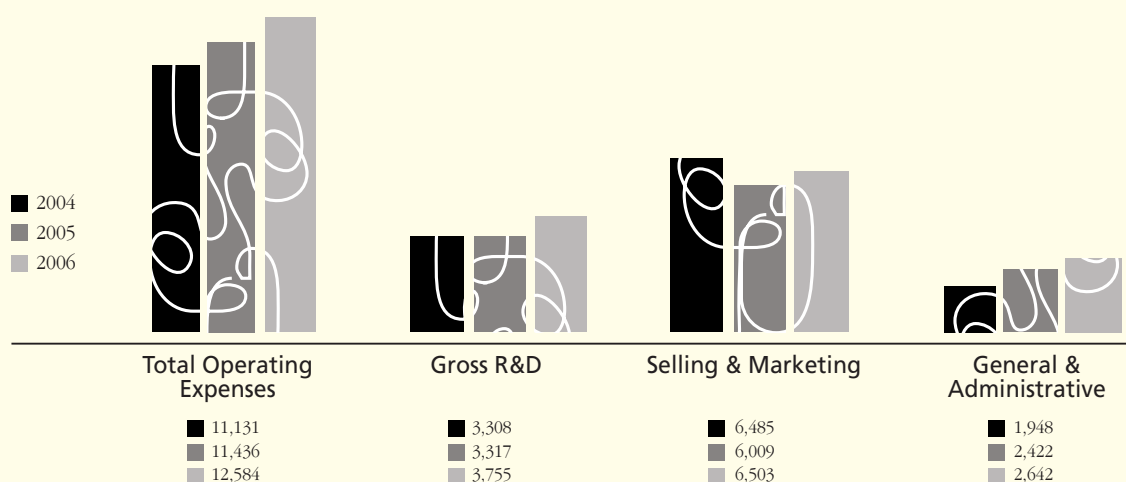
General and Administrative Expenses

General and Administrative expenses increased by 23.5% in 2006. Proforma expenses (excluding stock-based compensation expense) increased by 9.1% compared with 2005. The increase is mostly attributable to a general provision for doubtful debts of \$75 thousand, recorded in the first quarter of 2006. General and administrative expenses, excluding the above mentioned provision and stock-based compensation expense, increased by only 6%, compared with 2005.

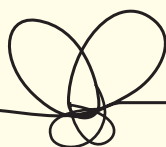
Amortization of deferred stock-based compensation

Based on SFAS 123R we recorded share-based payments as expenses based on their fair value, commencing January 1, 2006. The compensation is recorded over the requisite service period. During 2006 we applied the Modified Prospective without restatement (MPA) method and recorded the previous unvested awards measured according to SFAS 123 and the new awards measured according to SFAS 123R. The measurement of the benefit is based on the Monte Carlo Simulation. Total stock-based compensation expense recorded during 2006 was \$582 thousand.

Analysis of proforma consolidated Operating Expenses (excluding stock-based compensation expense) for each of the three years ended December 31, 2006, 2005, and 2004:



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



Operating and Net Income

Proforma operating income for 2006 (excluding amortization of deferred stock-based compensation expenses) increased from a profit of \$4,038 thousand in 2005 to a profit of \$5,097 thousand in 2006 representing an increase of 26.2%. Proforma operating income represented 17.9% of revenues in 2006 compared with 16.1% of revenues in 2005. Proforma EBITDA for 2006 increased by 23.8% from a profit of \$4,310 thousand in 2005 to a profit of \$5,334 thousand. Net Income for the full year ended December 31, 2006 was \$5,414 thousand, or \$1.13 per share (diluted) compared with a net income of \$4,201 thousand for 2005, or \$0.90 per share (diluted).

Financial Income, net

Net financial income in 2006 was \$1,231 thousand compared with \$30 thousand in 2005.

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 increase in financial income is attributable to the devaluation of the U.S. Dollar to the Israeli currency and to the Euro during 2006. Financial income for 2006 accounted for \$913 thousand compared to \$686 thousand for 2005, added to exchange rate differences and other interest and bank charges of \$318 thousand during 2006.

Taxes

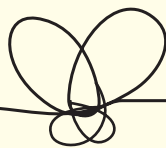
We operate within multiple taxing jurisdictions and are subject to audit in those jurisdictions. During 2005 the Israeli tax authorities have concluded a tax assessment for the years 2001-2004. We have incorporated the results of that assessment in the tax expenses on the Statement of Operations. During 2003 we conducted a Transfer Pricing study in the United States and during 2005 we conducted a study in Germany. 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 1 2003 and potential tax liability in other jurisdictions.

Liquidity and Capital Resources

As of December 31, 2006 we had approximately \$31.8 million of cash and cash equivalents, short and long-term investments compared with \$25.4 million at December 31, 2005. The increase of cash level in 2006 is due to the increase in revenues and order intake and to our increased profitability.

In 2006, \$6,209 thousand were provided by operating activities compared with \$4,451 thousand in 2005. 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 2006. 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 2006 was 59 days compared with 61 days at the end of 2005. Our 2006 capital expenditures on fixed assets were \$407 thousand compared with \$160 thousand used during 2005. As of December 31, 2006 we have no commitment for capital expenditures.

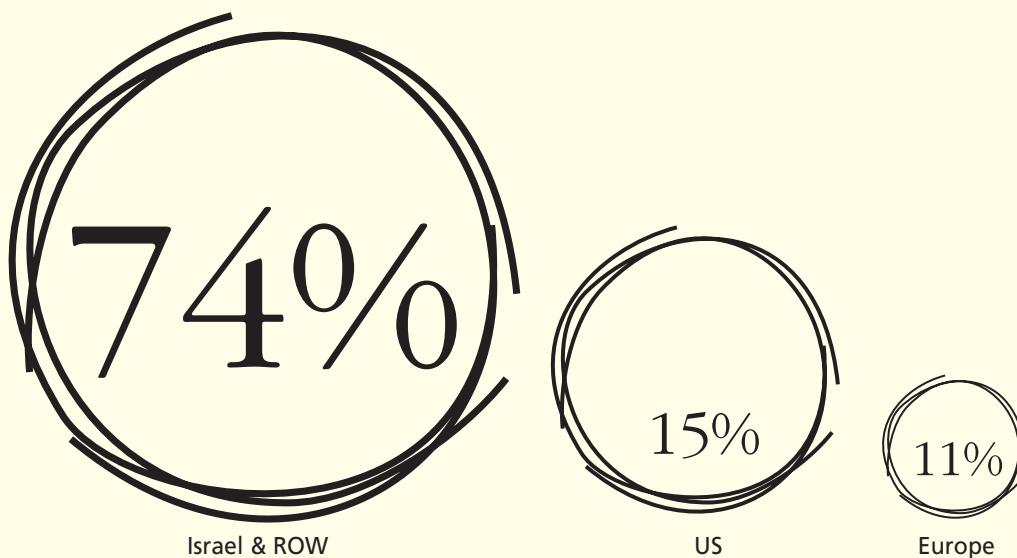
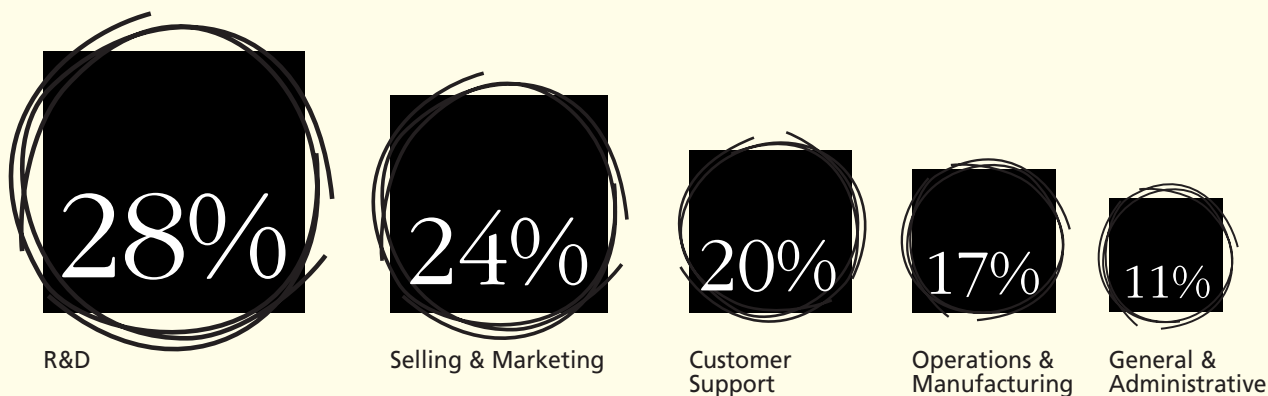
Management's Discussion and Analysis of Financial Condition and Results of Operations



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 that are the key ingredients of healthy growth.

On December 31, 2006, 123 people were employed by AVT worldwide compared with 109 at December 31, 2005. The breakdown of employees by activity is as follows:



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Report of Independent Auditors

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



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, 2006 and 2005, 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, 2006. 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, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2m to the consolidated financial statements, in 2006 the Company adopted Statement Financial Accounting Standards Board No. 123 (revised 2004) "Share-Based Payment".

Tel-Aviv, Israel
March 29, 2007

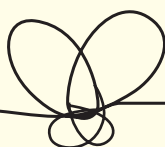
Kost Forer Gabbay and Kassierer
Kost Forer Gabbay & Kassierer
A Member of Ernst & Young Global

Consolidated Balance Sheets

U.S. Dollars in thousands

December 31,	2006	2005
Assets		
Current assets:		
Cash and cash equivalents	22,227	7,701
Available for sale marketable securities	1,019	-
Held to maturity marketable securities	7,493	9,227
Trade receivables (net of allowance for doubtful accounts of 129 and 53 as at December 31, 2006 and 2005, respectively)	4,798	4,421
Other accounts receivable and prepaid expenses	1,896	1,516
Inventories	2,681	2,462
Total current assets	40,114	25,327
Long-term investments:		
Held to maturity marketable securities	1,000	8,505
Severance pay fund	1,459	1,195
Total long-term investments	2,459	9,700
Deferred taxes	337	337
Property and equipment, net	650	480
Goodwill	825	825
Total assets	44,385	36,669

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

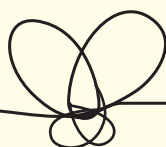


Consolidated Balance Sheets

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

December 31,	2006	2005
Liabilities and shareholders' equity		
Current liabilities:		
Trade payables	934	1,042
Employees and payroll accruals	1,467	1,253
Customer advances	1,787	998
Accrued expenses and other liabilities	2,650	2,731
Total current liabilities	6,838	6,024
Accrued severance pay	2,282	1,884
Commitments and contingent liabilities		
Shareholders' equity:		
Share capital:		
Ordinary shares of NIS 2 par value: 7,013,500 shares authorized at December 31, 2006 and 2005; 6,296,898 shares issued at December 31, 2006 and 2005; 4,538,796 and 4,417,740 shares outstanding at December 31, 2006 and 2005, respectively		
	3,402	3,402
Additional paid-in capital	55,303	54,721
Treasury shares at cost	(14,815)	(15,866)
Accumulated other comprehensive income	26	-
Accumulated deficit	(8,651)	(13,496)
Total shareholders' equity	35,265	28,761
Total liabilities and shareholders' equity	44,385	36,669

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

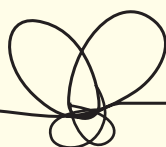


Consolidated Statement Of Operations

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

Year Ended December 31,	2006	2005	2004
Revenues	28,469	25,143	21,358
Cost of revenues	10,839	9,671	8,283
Gross profit	17,630	15,472	13,075
Operating expenses:			
Research and development	3,808	3,323	3,339
Less - grants	(316)	(312)	(610)
Selling and marketing	6,605	6,019	6,541
General and administrative	3,018	2,443	2,064
Total operating expenses	13,115	11,473	11,334
Operating income	4,515	3,999	1,741
Financial income, net	1,231	30	661
Income before taxes on income	5,746	4,029	2,402
Taxes on income (tax benefit)	332	(172)	199
Net income	5,414	4,201	2,203
Basic earnings per share	1.20	0.96	0.51
Diluted earnings per share	1.13	0.90	0.48

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

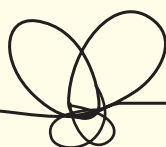


Statements of Changes in Shareholders' Equity

U.S. Dollars in thousands

	Share capital	Additional paid-in capital	Deferred stock-based compensation	Treasury shares	Accumulated other comprehensive income	Accumulated deficit	Total comprehensive income	Total Shareholders' equity
Balance as of January 1, 2004	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	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	4,201
							4,201	
Balance as of December 31, 2005	3,402	54,721	-	(15,866)	-	(13,496)	-	28,761
Exercise of options	-	-	-	1,051	-	(569)	-	482
Stock-based compensation related to options granted to employees	-	582	-	-	-	-	-	582
Unrealized gain on available for sale marketable securities	-	-	-	-	26	-	26	26
Net income	-	-	-	-	-	5,414	5,414	5,414
							5,440	
Balance as of December 31, 2006	3,402	55,303	-	(14,815)	26	(8,651)	-	35,265

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

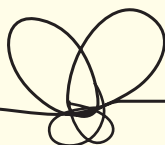


Consolidated Statements of Cash Flows

U.S. Dollars in thousands

Year ended December 31,	2006	2005	2004
Cash flows from operating activities:			
Net income	5,414	4,201	2,203
Adjustments to reconcile net income to net cash provided by operating activities:			
Stock-based compensation related to options granted to employees	582	39	214
Depreciation and amortization of property, equipment and technology	237	272	321
Amortization of marketable securities premium and accretion of discount	4	51	205
Increase in trade receivables	(377)	(915)	(999)
Decrease (increase) in other accounts receivable and prepaid expenses	(380)	(6)	330
Decrease (increase) in inventories	(219)	738	(1,053)
Deferred taxes	-	(337)	-
Increase (decrease) in trade payables	(108)	(8)	135
Increase in employees and payroll accruals	214	124	399
Increase (decrease) in customer advances, accrued expenses and other liabilities	708	113	(465)
Increase in accrued severance pay, net	134	179	45
Net cash provided by operating activities	6,209	4,451	1,335
Cash flows from investing activities:			
Proceeds from redemption of marketable securities	10,235	7,940	7,505
Purchase of held to maturity marketable securities	(1,000)	(9,496)	(10,500)
Purchase of available for sale marketable securities	(993)	-	-
Purchase of property and equipment	(407)	(160)	(155)
Net cash provided by (used in) investing activities	7,835	(1,716)	(3,150)
Cash flows from financing activities:			
Proceeds from sale of treasury shares	-	85	-
Proceeds from exercise of options	482	45	3
Net cash provided by financing activities	482	130	3
Increase (decrease) in cash and cash equivalents	14,526	2,865	(1,812)
Cash and cash equivalents at the beginning of the year	7,701	4,836	6,648
Cash and cash equivalents at the end of the year	22,227	7,701	4,836

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 and Advanced Vision Technology (Germany) GmbH located in Germany.

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 is 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". 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:

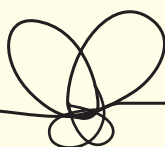
The consolidated financial statements include the accounts of A.V.T. and its wholly-owned subsidiaries. Intercompany transactions and balances, including profits from intercompany sales not yet realized outside the Company, have been eliminated upon consolidation.

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".



Notes to Consolidated Financial Statements

Management determines the appropriate classification of its investments in marketable debt and equity 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. Equity securities are classified as available for sale at fair value, with the unrealized gains and losses, net of tax, reported in other comprehensive income.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity based on the effective interest method. 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. 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 and finished products - based on average direct manufacturing costs and allocable indirect manufacturing costs.

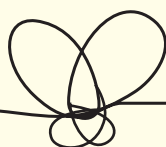
The Company evaluates periodically the quantities on hand relative to current selling prices and historical and forecasted sales volume. Based on these evaluations, provisions are recorded if required to write down inventory to its net realizable value. Such provisions are included in the cost of revenues. 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 the carrying amount of the assets exceeds the fair value of the assets. No impairment losses have been identified during 2004, 2005 and 2006.



Notes to Consolidated Financial Statements

h. Goodwill and other intangible assets:

Goodwill represents the excess of the cost over the fair value of the net assets of an acquired business. Under SFAS No. 142, "Goodwill and Other Intangible Assets", 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. As the fair value of the Company has exceeded its carrying value, goodwill has not been considered impaired 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, 2006, 2005 and 2004 was \$ 0, \$ 57 and \$ 58, respectively.

i. Research and development costs:

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

j. Revenue recognition:

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

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.

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 installation and training services, which are considered not essential to the functionality of the products and does not grant its customers any rights of return. Accordingly, payments which are not payable until the undelivered not essential service is delivered, are deferred until that service is delivered.

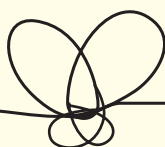
Revenues from repair services are recognized at the time the services are rendered while revenues from maintenance and support agreements are deferred and recognized on a straight-line basis over the term of the agreement. Up front payments for sales not yet recognized are recorded as customer advances.

k. Warranty costs:

The Company provides a 12 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 for 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

	2006	2005
Balance, beginning of year	548	364
Warranties expired during the year	(548)	(364)
Warranties issued during the year	559	548
Balance, end of year	559	548



Notes to Consolidated Financial Statements

I. Concentrations of credit risk:

Cash and cash equivalents are deposited with major banks in Israel and in 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 are comprised of investments in bonds and equity securities of 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.

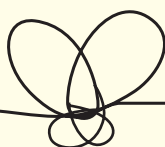
The Company has no off-balance-sheet concentration of credit risk such as forward exchange contracts, option contracts or other foreign currency hedging arrangements.

m. Stock-based compensation:

On January 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), requiring to recognize expense related to the fair value of its stock-based compensation awards. The Company elected to use the modified prospective transition method as permitted by SFAS 123R and therefore has not restated its financial results for prior periods. Under this transition method, stock-based compensation expense for the year ended December 31, 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. Stock-based compensation expense for all stock-based compensation awards granted subsequent to January 1, 2006 was based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. The Company recognizes compensation expense for stock option awards on a straight-line basis over the requisite service period of the award.

In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

Prior to the adoption of SFAS 123R, the Company applied SFAS No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure", which allowed companies to apply the existing accounting rules under APB 25, "Accounting for Stock Issued to Employees" and related interpretations. In general, as the exercise price of options granted under these plans was equal to the market price of the underlying Ordinary shares on the grant date, no stock-based employee compensation cost was recognized in net income for periods prior to the adoption of SFAS 123R. As required by SFAS 148 prior to the adoption of SFAS 123R, the Company provided pro forma net income and pro forma earnings per share disclosures for stock-based awards, as if the fair-value-based method defined in SFAS 123 had been applied.



Notes to Consolidated Financial Statements

The following table illustrates the effect on net income and basic and diluted net earnings per share for the years ended December 31, 2005 and 2004 under the fair value recognition provisions of SFAS 123:

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

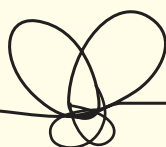
Year ended December 31,	2005	2004
Net income as reported	4,201	2,203
Add - stock-based employee compensation - intrinsic value included in reported net income	39	214
Deduct - stock-based employee compensation - fair value	(539)	(810)
Pro forma net income	3,701	1,607
Basic earnings per share, as reported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

The fair value for these options was estimated at the date of grant, using the Black-Scholes Option Valuation Model through September 30, 2005 and the Monte Carlo simulation model for options granted thereafter:

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

Year ended December 31,	2006	2005	2004
Risk-free interest rate	4.0%	3.5%	3.9%
Suboptimal exercise multiple	3	3	-
Forfeiture rate	8.15%	16.67%	-
Dividend yield	-	-	-
Expected volatility	71%	70%	50%
Weighted average expected life	5.99 years	5.32 years	5 years

The computation of expected volatility is based on historical volatility. The interest rate for periods within the contractual life of the award is based on the U.S. Treasury yield curve in effect at the time of grant. The suboptimal exercise factor represents the value of the underlying share as a multiple of the exercise price of the option which, if achieved, results in exercise of the option. The Company has historically not paid dividends and has no foreseeable plans to issue dividends. The expected term of options granted is derived from the output of the Monte Carlo simulation and represents the period of time that options granted are expected to be outstanding.



Notes to Consolidated Financial Statements

n. Comprehensive income:

The Company accounts for comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income". This statement establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in stockholders' equity during the period except those resulting from investments by, or distributions to, stockholders. The Company determined that its items of comprehensive income relate to gain and loss on hedging derivative instruments and unrealized gains and losses on available for sale securities.

o. Treasury stock:

On March 17, 2003, the Company repurchased some of its shares in a tender offer and thereafter held those shares as treasury shares. The Company presents the cost to repurchase treasury shares as a reduction of shareholders' equity.

From time to time the Company may reissue treasury shares under the stock purchase plan, upon exercise of option. When treasury share is reissued, the Company accounts for the re-issuance in accordance with Accounting Principles Board No. 6, "Status of Accounting Research Bulletins" ("APB No. 6") and charges the excess of the purchase cost over the re-issuance price (loss) to retained earnings. The purchase cost is calculated based on the specific identification method. In case the purchase cost is lower than the re-issuance price, the Company credits the difference to additional paid-in capital.

p. 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 \$ 316, \$ 312 and \$ 610 in 2006, 2005 and 2004, respectively. Total royalties accrued or paid amounted to \$ 996, \$ 881, and \$ 747 in 2006, 2005 and 2004, respectively and were recorded in the cost of revenues.

No marketing grants were received during 2006, 2005 and 2004. Total royalties accrued or paid to the Fund for the Encouragement of Marketing Activities amounted to \$ 0, \$ 76 and \$ 243 in 2006, 2005 and 2004, respectively, and were recorded as selling and marketing expenses.

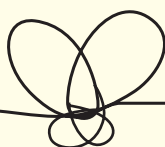
q. Fair value of financial instruments:

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).

r. 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.



Notes to Consolidated Financial Statements

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, 2006, 2005 and 2004 amounted to \$ 398, \$ 288 and \$ 194, respectively.

s. Basic and diluted earnings per share:

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

t. 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.

u. Impact of recently issued accounting pronouncements:

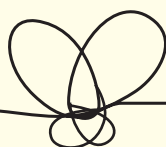
1. In July 2006, the FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109" (FIN 48"). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis that is more-likely-than-not to be realized upon ultimate settlement.

FIN 48 applies to all tax positions related to income taxes subject to the statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes". This includes tax positions considered to be routine" as well as those with a high degree of uncertainty.

FIN 48 has expanded disclosure requirements, which include a tabular roll forward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. These disclosures are required at each annual reporting period unless a significant change occurs in an interim period.

FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect of applying FIN 48 will be reported as an adjustment to the opening balance of retained earnings.

The Company is currently evaluating the effect of the adoption of FIN 48 on its financial statements.



Notes to Consolidated Financial Statements

2. In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("FAS No. 157"). This Statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS No. 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS No. 123(R) and related interpretations. The Statement does not apply to accounting standards that require or permit measurement similar to fair value but are not intended to measure fair value. This pronouncement is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 157.
3. In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 does not require new fair value measurements but rather defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the impact of SFAS 157 on its consolidated financial position and results of operations.
4. In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Liabilities - Including an Amendment of FASB Statement No. 115" (SFAS 159). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value and also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS 159 to have a significant impact on its consolidated results of operations, financial position or liquidity.

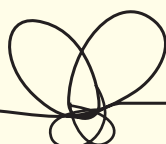
3 Marketable Securities

As of December 31, 2006 and 2005, the Company's securities are classified into available for sale and held-to-maturity marketable securities.

The following is a summary of marketable securities:

U.S. Dollars in thousands

December 31,	2006				2005			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Market value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Market value
Held-to-maturity:								
U.S. corporate bonds	8,493	-	(33)	8,460	17,732	-	(147)	17,585
Available for sale:								
Equity securities	993	26	-	1,019	-	-	-	-



Notes to Consolidated Financial Statements

The gross unrealized losses on the Company's 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, 2006, management believes that no gross unrealized losses represent other-than-temporary impairment.

The amortized cost and estimated fair value of marketable debt securities as of December 31, 2006 and 2005 by contractual maturity, are as follows:

U.S. Dollars in thousands

December 31,	2006				2005			
	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	7,493	-	(30)	7,463	9,227	-	(70)	9,157
Due in one to two years	1,000	-	(3)	997	8,505	-	(77)	8,428
	8,493	-	(33)	8,460	17,732	-	(147)	17,585

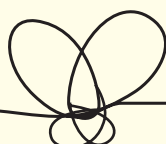
The unrealized losses on the Company's investments in debt securities are due to interest rate increases. Out of the unrealized loss as of December 31, 2006, 4 of losses are outstanding over than 12 months period. Since the Company has the ability and intent to hold these investments until a recovery of fair value, which may be until maturity, the Company does not consider these investments to be other-than-temporarily impaired as of December 31, 2006.

The actual maturity may differ from the contractual maturities, because debtors may have the right to call or prepay obligations without penalties.

④ Other Accounts Receivable and Prepaid Expenses

U.S. Dollars in thousands

December 31,	2006	2005
Government grants	246	158
Government authorities	701	673
Accrued interest	111	146
Prepaid expenses	835	348
Other accounts receivable	3	191
	1,896	1,516



Notes to Consolidated Financial Statements

5 Inventories

U.S. Dollars in thousands

December 31,	2006	2005
Raw materials	1,135	1,305
Work in progress	980	440
Finished products	566	717
	2,681	2,462

6 Property and Equipment

U.S. Dollars in thousands

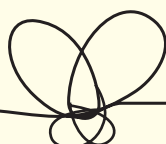
December 31,	2006	2005
Cost:		
Computers and peripheral equipment	1,663	1,295
Machinery and equipment	330	325
Office furniture and equipment	171	166
Leasehold improvements	142	113
	2,306	1,899
Accumulated depreciation:		
Computers and peripheral equipment	1,242	1,048
Machinery and equipment	242	224
Office furniture and equipment	85	72
Leasehold improvements	87	75
	1,656	1,419
Property and equipment, net	650	480

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 was \$ 237, \$ 215 and \$ 263, respectively. For liens, see Note 8c.

7 Accrued Expenses and Other Liabilities

U.S. Dollars in thousands

December 31,	2006	2005
Provision for warranty costs	559	548
Government authorities	582	528
Accrued expenses and other liabilities	1,509	1,655
	2,650	2,731



Notes to Consolidated Financial Statements

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 2012.

Future minimum lease commitments under non-cancelable operating leases as of December 31, 2006, are as follows:

U.S. Dollars in thousands

Year	Lease commitment
2007	944
2008	1,281
2009	996
2010	705
2011	705
2012	705
	5,336

Total lease expense for the years ended December 31, 2006, 2005 and 2004 amounted to \$1,063, \$ 900 and \$ 889, respectively.

b. 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 3.5% 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, 2006, the Company has a contingent obligation to pay royalties in respect of the aforementioned grants in the approximate amount of \$ 3,370.

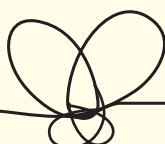
c. Liens:

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

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.



Notes to Consolidated Financial Statements

b. Israel taxation:

1. Corporate tax structure:

Taxable income of Israeli companies is subject to tax at the rate of 31% in 2006, 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.

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 abovementioned tax benefits period has commenced in the year ended December 31, 2006 and is scheduled to gradually expire by 2015.

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.

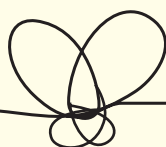
The entitlement to the above benefits is conditional upon the Company's fulfillment of the conditions stipulated by the above Law, regulations published thereunder and the letters of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, 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 Consumer 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 period of benefits, such income shall be taxable at the regular corporate tax rate.

The 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 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



Notes to Consolidated Financial Statements

Approved Enterprises 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 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, 2006, the Company did not generate income subject to the provisions of the Amendment.

c. Carryforward tax losses:

As of December 31, 2006, the U.S. subsidiary had U.S. federal carryforward tax losses of approximately \$ 3,200 that can be carried forward and offset against taxable income for 15-20 years and expire from 2011-2022.

As of December 31, 2006, the German subsidiary had carryforward tax losses of approximately \$ 1,300 which may be carried forward and offset against taxable income in the future for an indefinite period.

d. Final tax assessments:

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

e. Deferred income taxes:

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

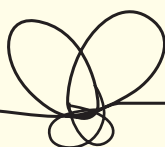
U.S. Dollars in thousands

December 31,	2006	2005
Deferred tax assets:		
Operating loss carryforwards	3,129	2,582
Reserves and allowances not currently deductible	523	850
Deferred tax asset before valuation allowance	2,606	1,732
Valuation allowance	(2,269)	(1,395)
Domestic:		
Non current deferred tax asset	337	337

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

U.S. Dollars in thousands

Year Ended December 31,	2006	2005	2004
Domestic	7,803	1,430	3,014
Foreign	(2,057)	2,599	(612)
	5,746	4,029	2,402



Notes to Consolidated Financial Statements

g. Taxes on income are comprised as follows:

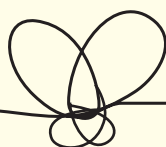
U.S. Dollars in thousands

Year Ended December 31,	2006	2005	2004
Current	332	(509)	199
Deferred	-	337	-
	332	(172)	199
Domestic	270	(157)	190
Foreign	62	(15)	9
	332	(172)	199

h. Reconciliation of the theoretical tax expense:

U.S. Dollars in thousands

Year Ended December 31,	2006	2005	2004
Income before taxes on income	5,746	4,029	2,402
Statutory tax rate	31%	34%	35%
Theoretical tax at statutory tax rate	1,781	1,370	841
Increase (decrease) in respect of:			
Losses, reserves and allowances for which valuation allowance was provided	719	24	161
Utilization of carryforward losses for which valuation allowance was provided in prior years	(1,290)	(1,064)	(119)
Tax adjustment in respect of "Approved Enterprise" status	(1,318)	(566)	(748)
Non-deductible expenses	440	64	64
Actual tax expense (benefit)	332	(172)	199



Notes to Consolidated Financial Statements

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, out of which 124,650 treasury shares were issued to employees as result of exercise of options made by those employees and 8,000 treasury shares were sold in September 2005 at \$ 85, in order to comply with certain requirements of the Law for the Encouragement of Capital Investments, 1959. As of December 31, 2006 and 2005, the Company is holding 1,758,102 and 1,882,752 treasury shares, respectively.

b. The Company's options held as of December 31, 2006 by executive management and members of the Board of Directors of the Company, are as follows:

Name	Number of stock options held	Number of shares held
Executive Management		
Shlomo Amir	138,882	82,562
Danny Danziger	16,500	2,050
Zev Morgenstern	15,500	-
Noam Noy	22,500	1,505
Koby Shtaierman	16,500	-
Lance Shumaker	27,125	-
Gal Shamri	15,000	-

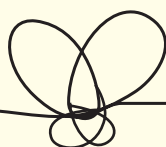
Name	Number of stock options held	Number of shares held
Board of Directors		
Michael Goldstein	120,250	61,512
Allan Green	15,000	-
Pierre Francois Veil	15,000	-
Michael Sessler	15,000	-
Yona Admon	15,000	-
Itzhak Krinski	15,000	-

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, 2006, 2005 and 2004 was \$ 0, \$ 39 and \$ 214, 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 2,096,050 Ordinary shares.



Notes to Consolidated Financial Statements

Options granted under the four plans expire between six to 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 three to four year periods. Any options that are cancelled or forfeited before expiration become available for future grants.

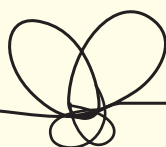
As of December 31, 2006, 361,959 options are available for future grants.

A summary of the stock option activities in 2006 is as follows:

	Amount	Weighted average exercise price	Weighted average remaining contractual life	Aggregate Intrinsic value
Outstanding at January 1, 2004	606,329	3.09		
Granted	357,000	6.88		
Exercised	(122,834)	0.02		
Forfeited	(92,584)	5.52		
Outstanding at December 31, 2004	747,911	5.10		
Granted	34,000	11.74		
Exercised	(64,901)	0.69		
Forfeited	(35,750)	6.15		
Outstanding at December 31, 2005	681,260	5.80		
Granted	76,000	6.82		
Exercised	(121,056)	3.98		
Forfeited	(10,000)	2.83		
Outstanding at December 31, 2006	626,204	6.32	7.07	9,732
Exercisable at December 31, 2006	283,204	5.51	6.72	4,401
Vested and expected to vest at				
December 31, 2006	574,451	9.98	4.72	3,195

As of December 31, 2006, \$ 832 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.07 years. The aggregate intrinsic value represents the total intrinsic value (the difference between the Company's closing stock price on the last trading day of fiscal year 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2006.

The weighted-average grant-date fair value of options granted during the years 2006, 2005 and 2004 was \$ 7.35, \$ 5.74, and \$ 3.09, respectively. The total intrinsic value of options exercised during the years ended December 31, 2006 and 2005 was \$ 1,768 and \$ 809, respectively.



Notes to Consolidated Financial Statements

Following are the outstanding options by exercise price as of December 31, 2006:

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

Exercise price	Options outstanding as of December 31, 2006	Weighted average remaining contractual life	Options exercisable as of December 31, 2006
-	65,113	6.050	38,613
2.12	2,500	5.477	2,500
4.08	1,334	2.277	1,334
4.35	113,875	6.595	71,875
5.77	30,000	7.329	20,000
6.84	240,000	7.570	80,000
6.92	4,500	7.099	-
7.54	48,882	6.693	38,882
8.00	40,000	7.849	20,000
8.57	4,000	8.252	-
11.00	27,000	5.082	-
11.39	15,000	5.449	-
12.16	30,000	8.915	10,000
12.58	4,000	9.085	-
6.32	626,204	7.070	283,204

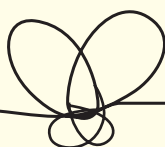
Weighted-average fair values and weighted-average exercise prices of options at the date of grant during the years 2006 and 2005 are \$ 7.35 and \$ 6.82, respectively.

The following table sets forth the total stock-based compensation expense resulting from stock options:

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

Year Ended December 31,	2006	2005	2004
Cost of revenues	51	11	18
Research and development, net	53	31	48
Selling and marketing	102	56	88
General and administrative	376	116	182
Total stock-based compensation expense	582	214	336

e. As of December 31, 2006, 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.



Notes to Consolidated Financial Statements

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,	2006	2005	2004
Net income	5,414	4,201	2,203
Weighted average Ordinary shares outstanding -			
Basic EPS	4,494,079	4,370,771	4,306,774
Dilutive effect:			
Employee stock options	282,377	291,322	255,540
Weighted average Ordinary shares outstanding -			
Diluted EPS	4,776,456	4,662,093	4,562,314
Basic earnings per share	1.20	0.96	0.51
Diluted earnings per share	1.13	0.90	0.48

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 11,160, 13,872 and 110,092 for the years ended December 31, 2006, 2005 and 2004, respectively.

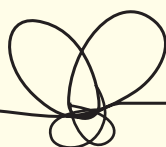
12 Segment Information

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

Year ended December 31,	2006	2005	2004
Revenues based on the customer's location:			
United States	13,408	8,284	4,805
Europe (other than Germany)	7,641	7,282	7,931
Germany	3,005	2,940	2,817
Other	4,415	6,637	5,805
	28,469	25,143	21,358



Notes to Consolidated Financial Statements

U.S. Dollars in thousands

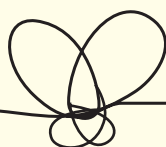
December 31,	2006	2005
Long-lived assets by geographic location:		
Israel	1,417	1,200
Europe	19	68
United States	39	37
	1,475	1,305

13 Selected Statements of Operations Data

Financial income, net:

U.S. Dollars in thousands

Year Ended December 31,	2006	2005	2004
Financial income:			
Interest	913	686	770
Foreign currency translation differences, net	396	-	167
	1,309	686	937
Financial expenses			
Bank charges	78	83	76
Foreign currency translation differences, net	-	500	-
Other	-	73	200
	78	656	276
	1,231	30	661



Report of the Board of Directors

Dear Shareholders,

During 2006 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.

As of December 31st 2006, the Board of Directors consisted of seven members, including two external Directors. Board meetings focused on strategies for profitable growth through business development in emerging markets that have shown high potential for expansion 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 2006, we held 8 Board of Directors meetings, 5 audit Committee meetings, and various Board committee meetings. All Board of Directors meetings consisted of a legal quorum of more than four attendees and the Audit Committee was attended at least by 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, 2006 and 2005, 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, 2006, were audited by KOST FORER GABBAY & KASIERER, a member of Ernst & Young Global.

In the Audit Committee and Board of Director meetings held on January 25th, 2007, attended by the company's auditors and legal counsel, we discussed the 2006 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 29th, 2007



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.