So What's New?

AVT Annual Report 2007

Advanced Vision Technology Ltd.

Financial Highlights

US Dollars in thousands (except per share amounts)

Year ended December 31,	2007	2006	2005
Revenues and Income			
Revenues	39,884	28,469	25,143
Gross profit	23,016	17,630	15,474
Gross margin in %	57.71%	61.93%	61.54%
Research and development expenses, net	6,374	3,492	3,005
Sales and marketing expenses, net	9,888	6,605	6,009
General and administrative expenses	4,709	3,018	2,422
Amortization of deferred stock-based compensation	731	582	39
Operating profit	908	4,515	3,999
Operating margin in %	2.28%	15.86%	15.91%
Net income	4,815	5,414	4,201
Cash Flow			
Cash flow provided by operating activities	8,233	6,209	4,451
Cash flow provided by (used in) investing activities	-23,972	7,835	-1,716
Cash flow provided by financing activitie	10,165	482	130
Balance sheet as of December 31,			
Cash and cash equivalents	16,653	22,227	7,701
Total assets	73,699	44,385	36,669
Total liabilities	23,371	9,120	7,908
Total shareholders' equity	50,328	35,265	28,761
Share			
Basic earnings per share in USD	0.95	1.20	0.96
Share price as of December 31,	10.50 Euro	11.80 Euro	9.60 Euro
Employees			
Employees as of December 31,	309	123	109

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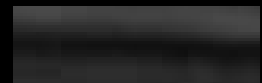
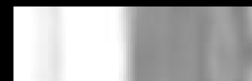
What's new at AVT is essentially the future. A future with greater technological breadth, a springboard to new market segments and a firmer foothold in emerging markets.

These are possibilities Generated by decisions we took in 2007.

Now we are ready to step up to the challenges, and to harness potential to reality.





Dear Shareholders,

In 2007 we continued our growth momentum; concurrently, we reported our first significant acquisition. We are encouraged by the complementary technological and marketing strengths delivered by this acquisition. We intend to make every effort to build on technological synergies and to grasp the opportunity to enter new market segments.

Stepping Up to New Horizons

Graphic Microsystems Inc. (GMI)

GMI, which we acquired in October, 2007, is the leading supplier of closed loop color control (CLC) systems, color management and reporting software, and remote digital ink fountain control systems. It in effect adds an extra dimension to the quality assurance process addressed by our defect detection platforms.

Furthermore, GMI primarily targets commercial, semi-commercial, newspaper and specialty printers. It opens the door of the commercial and newspaper world to AVT. We believe our technology can add significant value to these markets, in which we have not participated to date. When bundled with GMI solutions, AVT defect detection platforms will indeed be an unmatched comprehensive process control and quality assurance solution.

It is thus clear to envision the many new channels of opportunity the GMI acquisition represents: new capabilities for our label and packaging defect detection platforms, and an open road to new market segments. Just as AVT directly markets printers as well as printing system manufacturers, GMI has the same business model. We can set our sights high to the extension of our leadership position to new market segments and dimensions.

Strengthening Footprints in World Markets

New Agreements and Contracts

While the Chinese market may not yet be ripe for GMI's specialized technology at this point in time, we can expect that the accelerated rate of progress in this nation will soon put CLC in demand. Meanwhile, AVT continues to step briskly forward in this fast growing market.

In 2007, we signed a distribution agreement with partners in China, which will support our healthy growth in this market, particularly the label and narrow web segments.

Following an initial positive experience, Shenzhen Jinjia Color Printing Co. Ltd., China's largest cigarette packaging printer, placed a major order for several different AVT platforms, including the PrintVision/Argus and PrintVision/Helios. We have thus become Jinjia's chosen vendor for automatic print inspection solutions.

We hope these developments will mirror our steps in our traditional markets, where repeat orders and committed partnerships make up a salient part of our business.

In 2007, for example, we received a multi-unit order from the Polystar Group, which manages six package printing companies and nine converting facilities for high profile customers, such as JC Penny and Scott Paper. Our partnership with Polystar goes back to 2001, and is strengthened by the very considerable reduction in print waste Polystar has achieved, thanks to our solutions.

A new customer that has declared us their vendor of choice for automatic inspection and quality assurance is the Bopack Group, a leading label printer in France and Benelux, and a recognized expert in the label industry. An interesting facet of our alliance with Bopack is our participation in the company's unique initiative to integrate digital printing solutions in production sites for pharma applications, which are notably demanding and strict. The Bopack Group plans a series of projects to combine automatic web inspection with digital printing, and we are proud to be part of this breakthrough strategy.

Ascending to the Top

Industry Award and Trade Shows

We are proud to report our selection as the winner of the "New Innovation" Award in the Label Industry Global Awards 2007 competition.

This prestigious award is granted to an industry supplier that has made a measurable favorable impact on the label industry through outstanding innovations.

When our Printvision/Helios was introduced to the label market just three years ago, it introduced a new era in labels inspection. Its indisputable benefits soon made waves in the market, and this award is a confirmation of our success in educating the label market.

In 2007 our impact on the label industry was also witnessed by our successful participation in international trade shows. At LabelExpo Europe, live demonstrations were given at our booth, as well as at an additional nine partner booths.

At CMM 2007, we showcased both packaging and labels platforms, including very interesting press control solutions for challenging short runs.

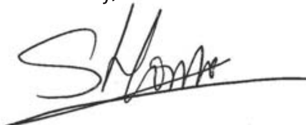
The Staircase to Tomorrow

A Measured Vision for Growth

At AVT we have always formulated our progress judiciously, weighing our innovation and marketing moves, and assessing the results realistically. Our history proves the viability and fiscal soundness of this approach.

Now our acquisition of GMI places us in a much larger playing field, and we look forward to addressing this opportunity. I thank our shareholders for placing their trust in us, and I thank our employees who are the heart of our achievements. Their motivation, creativity and very hard work are helping us to plant new roots while harvesting the rewards of proven technologies.

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.

Barry Ben Ezra , VP R&D
Prior to joining AVT in 2007, Mr. Ben-Ezra worked for 12 years at Orbotech Ltd., an Israel-based international high-tech company, serving the Printed Circuit Board and Flat Panel Display manufacturing industries. As VP of the PCB Division he established and lead the company's disruptive Maskless Lithography program, responsible for development of technology, products, market and business. Prior to that, Barry served for six years at Scitex Corp., an Israeli high-tech company, serving the pre-press industry, and as VP R&D at Cubital, a Desktop Manufacturing spin-off of Scitex. Barry holds a BSc degree in Mathematics and Computer Science from the University of Tel-Aviv.

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.

Niki Bassat, V.P. Operations

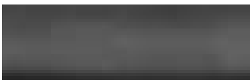
Mr. Bassat joined AVT from superDimension, a medical device company, where he was Chief Operating Officer and General Manager (Israel). Before that, he was Chief Operating Officer at RaySat, a manufacturer of in-motion satellite antennas. He was the Chief Operating Officer at Power Paper a provider of micro-powered devices. He was the Chief Operating Officer at SATLYNX, a pan-European two-way satellite broadband services provider, and served as managing director of SATLYNX GmbH. Prior to that, he was the Vice President, Operations, at Gilat Satellite Networks. Mr. Bassat also worked for Tadiran Telecommunications as Plant Manager. He holds a B.Sc. in industrial engineering from the Technion: Israel Institute of Technology, and studied MBA at the Hebrew University of Jerusalem. He is the recipient of several awards, including the Kaplan Prize (1990) and "Excellence in Quality" awards from the Israeli government (1991,1994).

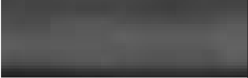
Gal Shamri, V.P. Marketing

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.





Stepping up to new Technology

When AVT took its first steps in the nineties of the last century, Automatic Optical Inspection – AOI, as it was then dubbed – was in its infancy. It had demonstrated its value in less than a handful of applications, and an intelligent forecast of its potential was far from being formulated.

Advanced Vision Technology – AVT, was thus diving off a high board when it set out to develop AOI for the print industry. It could either make a big splash, or could drown in the complexities of the new technology.

What was clear was the need – on the one hand, many segments of the print industry, such as packaging, were characterized by mass production. On the other hand, the quality assurance process was virtually entirely based on human capabilities – and therefore, by definition – human weaknesses. The fatigue or simple absent-mindedness of a QA employee could slash the yield and profits of the shop owner.

AVT's success in developing the first fully automated defect detection system for the print industry was in effect a revolution. As such, it underwent the birth pangs of most technological breakthroughs, the need to "educate" and "convince" printers that there was a much better way of ensuring quality.

AVT's success, and the continuing introduction of more advanced platforms, as well as its expansion into the labels segment, are by now part of industry lore. The question "why do we need it?" has long since been replaced by the demand "help us achieve an even higher level of perfection!".

Accessing a NEW Horizon

AVT's acquisition of Graphics Microsystems Inc. (GMI) in 2007 is a significant step up in its ambitious drive to fulfill customers' wish lists. As the world's leading supplier of closed loop color control (CLC) systems, color management and reporting software, and related technologies, GMI directly addresses one of the most problematic aspects of quality control in the print industry color consistency and quality.

Why is this so important?

Companies spend hundreds of millions of dollars on branding their products. The colors on their packaging and labels are one of the most salient aspects of brand expression. It is color that catches the consumer's eye on the crowded shelf; color that primarily reassures a patient he has bought the right medication; color that has an immediate, direct emotional impact on our mood and desire. Research has demonstrated that sometimes just changing the color of a particular item's packaging has a dramatic impact on its sales curve.

The integration of GMI's technology into AVT's PrintVision platforms will enable packaging and label printers to take a giant step forward towards the gold standard. The PrintVision family and its modules will become true "one stop" solutions, handling defect detection of all the main parameters of a print run.

The acquisition of GMI has been made at a period in AVT's industry that is indeed ripe for such a major step. AVT's achievement of steadily increasing profitability and sales testifies to its maturity. At the same time, the acquisition is excellent proof of the search for corporate vision.

Exploring NEW Spaces

It is a common modern saying that-
"the world is getting smaller".

But as it grows smaller thanks to communications and transportation advances, its opportunities expand exponentially. New markets are emerging, dramatically transforming quality of life and ways of life at the most basic levels. Ambitious economies are racing to catch up, and welcoming progress at an accelerated pace.

The acquisition of GMI is ideally positioning AVT to capture new market segments, offer an expanded product range to its current markets, and jumpstart its expansion into emerging markets. Thus, from any aspect that the merger is viewed, it represents exciting marketing opportunities.

GMI has to date, been primarily active in commercial, semi-commercial, newspaper and specialty printing. Having established strong roots in the packaging and labels markets, AVT is now ready to adapt its PrintVision technology to the commercial printing sector. GMI's presence there can be said to enable AVT to pass through an open, welcoming door. The target customers have already learned the value of automatic quality control, and can be expected to appreciate its application In a much wider context.

At the same time that you can expect to see AVT in new market segments, you will also be able to note its foray into high promise geographic territories, where consumer societies are on the cusp of development. AVT's penetration of the Chinese market has been as flexible as it has been judiciously planned. This market, for example, may not yet be ripe for GMI technology, but rising standards already generate growing demand for PrintVision models. Repeat orders and partnerships justify the drive to strengthen our presence in Asia, to boost sales of our core PrintVision platforms, and at a later stage, applications of GMI technology.

New Steps in the Right Direction

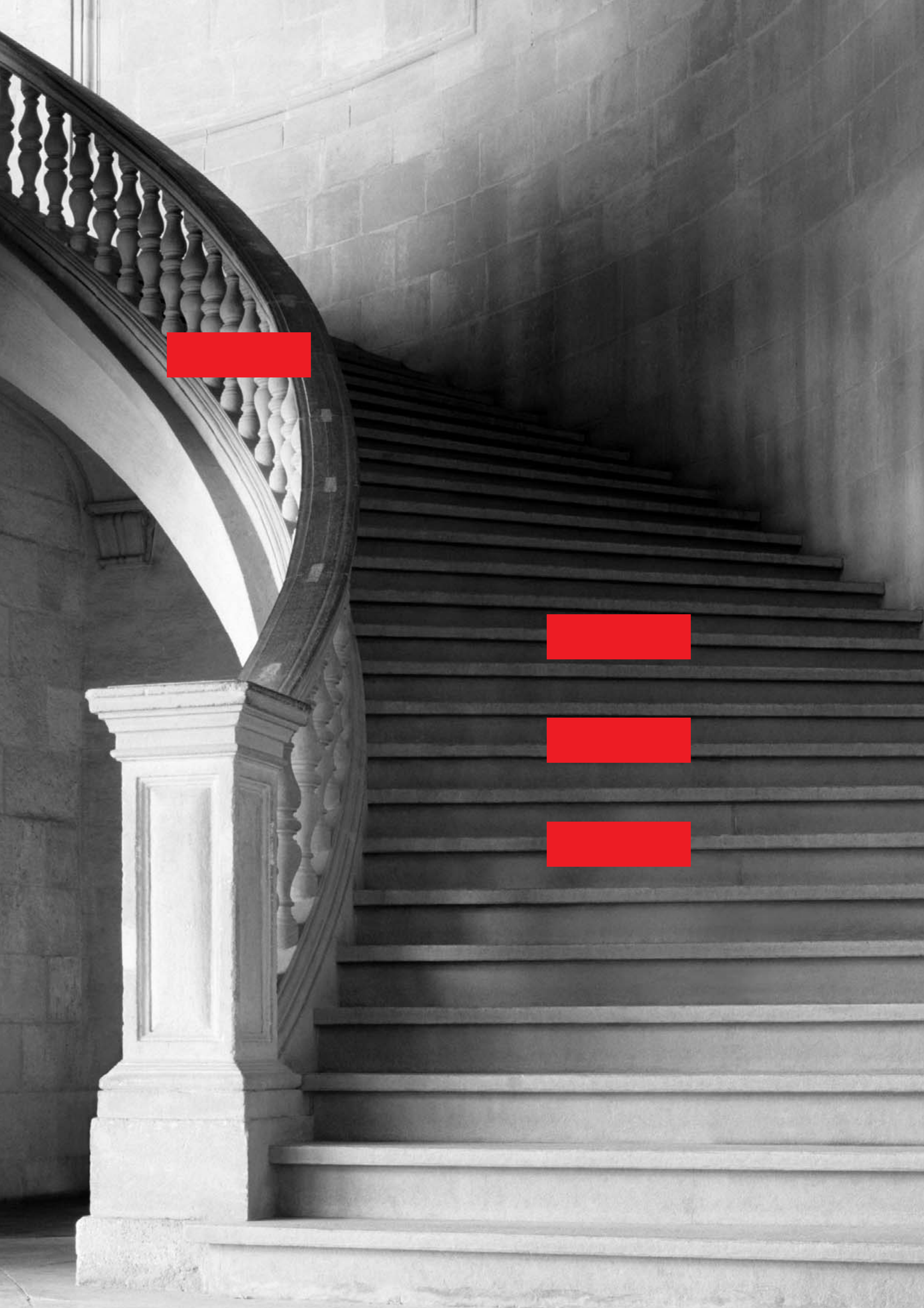
AVT's technological achievements have a very human underpinning. Technology at AVT is far from sterile lab wizardry.

At AVT, shop floor realities and requirements drive innovation. A continuous dialogue with both printers and manufacturers of printing equipment is part of a never-ending loop of response and feedback.

In business terms, this means steadily and reliably adding value to the customer's solutions. AVT's add-on modules are typically such value boosters. They enable printers to virtually customize their platforms with features that not only enhance defect detection performance, but also make better management of print operations achievable and affordable. In today's highly competitive markets, real-time information can be as valuable as manufacturing equipment.

As it plans its entry into the commercial printing market, and the integration of GMI technologies into the PrintVision family, AVT is determined to continue its R&D paradigm of need driven innovation. GMI's vast experience in color-related quality assurance gives us a head start. AVT's own modular approach to solution-building is particularly valuable in this context, as it lets the customer be the final decision-maker, and creates a long-term partnership.

This partnership is the culmination of listening, responding and delivering. It is not surprising that at international print trade shows, you will find not only an AVT booth, but AVT technology showcased at the stands of many print equipment manufacturers. Moreover, the industry recognizes our achievements with such accolades as the recent 2007 Label Industry Award.



Upwards and Onwards to a NEW Vision

A vision can empower the individual, the organization and the audiences it serves. But position your vision too high, and it may backfire, discouraging and disheartening. On the other hand, lack of an aspiring vision leads to the mundane, and to mediocrity. These are terminal illnesses for a technology company.

At this milestone in AVT's history, when we have the confidence and means to virtually double our work force, and take on new technological challenges, market segments and territories, we must indeed venture upwards - towards leadership in process and quality control in the entire print industry.

We have proven strengths as we welcome the future: technology, human resources and an impeccable reputation. Yet we must beware of hubris, and always be aware that our success, profits and growth are, in the final analysis, dependent on our customers.

In this respect, our vision has not changed: to be the preferred vendor of the most demanding customers, and to strive to surpass their expectations time and again.

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 flow; 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 statements, the related notes and other financial information included elsewhere in this annual report.

Our Solutions

We have developed fully integrated solutions that include software applications and hardware components that can be deployed in a modular manner. This flexibility allows our customers to incorporate additional functions and capabilities as their business or operation require.

Solution	Market Served	Purpose
PrintVision Jupiter	Packaging - on press Process Control	The industry standard solution for on-press automatic inspection. The PV/Jupiter offers superior Process Control capabilities that reduces production cost and enhances product quality. The PV/Jupiter can be equipped with added value modules such as press control, color management and barcode verification.
PrintVision/Apollo	Packaging - 100% Quality Assurance	Equipped with 100% LCCD technology, the PV/Apollo offers Quality Assurance solution and can be integrated on press or on various post press stages such as Lamination, Doctoring or slitting rewinding.
PrintVision/Helios	Labels and narrow web printing inspection applications	Advanced 100% automatic inspection platform that support the specific label & narrow web application & workflows. Installed on press or on rewinder, the PV/Helios provides excellent Process Control & 100% Quality Assurance.

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

Solution	Market Served	Purpose
PrintVision/Argus	Packaging - on press Process Control & Quality Assurance	A unique combination of Process Control & Quality Assurance. PV/Argus is the top of the line solution for high quality packaging applications.
pRegister		Automatic register pre-setting and control module.
Presco		Automatic plate pressure pre-setting and control module.
IΔEal		In line color measurement module for ΔE and ΔL*a*b-based color pre-setting guidance and run-time color management.
Microcolor II	Commercial printing/ Web Offset	Full-featured remote digital ink fountain control system suitable for use on virtually any sheetfed or web offset press, integrated into the printing units and allows the press operator to automatically and remotely control ink fountain key positions from a remote workstation.
ColorQuick	Commercial and newspaper printing/ Web Offset	Closed loop color control system that utilizes a spectrophotometer to measure colors that have been printed by a press. The CQ system converts spectrophotometric data to industry standard Status T or E ink density information and then compares the measured value to pre-defined job targets or standards. The system will automatically make adjustments to the press ink keys so that quality standards are met.
PrintQuick	Commercial printing/ Web Offset	A sophisticated automatic closed loop color-to-color register control designed for commercial presses.
RibbonQuick	Commercial printing/ Web Offset	An automatic system that determines and controls print-to-cut and print-to-fold position of web offset presses.

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, 2007 approximately 1,900 PrintVision platforms, 3,000 Microcolor systems and 750 ColorQuick systems were installed worldwide. No distributor or end-user accounted for more than 10% of revenues in 2007 and 2006.

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.

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

Recent Acquisition

On October 1, 2007, as part of our strategy of diversifying into new growth areas for process control technologies, AVT Inc., a wholly-owned subsidiary of AVT Ltd., acquired all of the outstanding shares of Graphics Microsystems Inc (GMI) and certain related intellectual property assets for approximately $33.5 million in cash (including transaction expenses of $0.5 million). GMI is a privately held US corporation, supplying Closed Loop Color control (CLC) systems, color management, reporting software, remote digital ink fountain control systems to leading commercial printers and press manufacturers worldwide.

The purchase price was allocated to the various assets acquired and liabilities assumed, based on a study conducted by an independent appraiser. The study determined the respective fair value of the various assets as follows:

- $9,766 thousand were allocated to Technology and will be amortized over the useful life estimated at 7 years.

- $1,137 thousand were allocated to In Process Research and Development and will be written off immediately at closing date.

- $1,396 thousand were allocated to Order Back-Log and will be amortized over 6 months commencing at the closing date.

- $1,839 thousand were allocated to Customer Relationship and Trade Marks and will be amortized over 10 years.

- The remainder in the amount of $18,412 was allocated to Goodwill.

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

The results of operations related to the acquisition for the period October 1, 2007 thru December 31, 2007 are included in our consolidated statements of income from the date of acquisition.

Via this acquisition, AVT is entering the lucrative commercial and newspaper printing markets. GMI's products are sold to leading commercial, semi-commercial, newspaper and specialty printers in the heatset and coldset web printing markets as well as printing press OEMs worldwide. In addition, GMI also supplies the industry with press controls, such as closed loop color-to-color register and ribbon/cutoff control systems.

By purchasing GMI, we strategically expanded our market share in the printing Industry both in market segments addressed and process control solutions offered. The factors that contributed to the purchase price that resulted in recognition of goodwill included synergies, the benefits of increased market share and strategic positioning value.

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; variations 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 2007 the European currency increased in value relative to the US Dollar by approximately 11.37%. In Israel, during 2007, the New Israel Shekel ("NIS") increased in value relative to the US Dollar by approximately 8.97%.

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 manufacturing, 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 packaging and labels products in our facility in Hod Hasharon, Israel. Our commercial printing and newspaper products as well as our Closed Loop Color Control solutions are manufactured at the GMI facility in Rockwall, Texas. Our products are built in accordance with industry standard infrastructure and are PC compatible. The hardware elements in our packaging and labels products are based primarily on standard commercial off-the-shelf components. The hardware elements for the commercial printing and newspaper products are primarily manufactured at the Rockwall facility. All products utilize proprietary in-house developed circuit boards and algorithms as well as image acquisition and image analysis techniques and software.

Some of the components we use have a single approved manufacturer while others have two or more options for purchasing. In addition, for some of the components and subassemblies we maintain an inventory to limit the potential for interruption. We also carry out relationships directly with some of the more significant manufacturers of our components. Although certain components and subassemblies, we use in our existing products, are purchased from a limited number of suppliers, we believe that we can obtain alternative sources of supply in the event that such suppliers are unable to meet our requirements in a timely manner.

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

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 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 and in the company's subsidiaries in the US. Approximately 45 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

- Stock-Based Compensation

Revenue recognition. 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 the payment is due.

Installation and training are not considered essential to the product capabilities since they do not require specialized skills and can be performed by other vendors. Accordingly, upon delivery of our commercial web offset and newspapers products, we defer revenue in an amount equivalent to the fair value of installation and training and recognize those deferred revenues once installation and training has been 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 fair value 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. 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

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

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 indicators that the asset has experienced a decline in value that is other than temporary. Based on our evaluation, during 2007 we did not record any impairment charge related to our long-lived assets. As of December 31, 2007 the carrying value of our long-lived asset was $33,241 thousand.

In assessing the recoverability of our property and equipment, goodwill and other intangible assets, we must make assumptions regarding the estimated future cash flow 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 2007 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.

SFAS No 142, "Goodwill and Other Intangible Assets," requires that goodwill be tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition or sale or disposition of a significant portion of a reporting unit. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting units goodwill over the implied fair value of that goodwill. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. The fair value of each reporting unit is estimated using a discounted cash flow methodology. This requires significant judgments including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, the useful life over which cash flows will occur and determination of our weighted average cost of capital. Changes in these estimates and assumptions could materially affect the determination of fair value and/or goodwill impairment for each reporting unit. We allocate goodwill to reporting units based on the reporting unit expected benefit from the acquisition. We evaluate our reporting units on an annual basis and, if required, reassign goodwill using a relative fair value allocation approach.

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, 2007 we had $19,237 thousand of non-amortized goodwill.

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

We are required to assess the impairment of long-lived assets, tangible and intangible, other than goodwill, under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" on a periodic basis, when events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment indicators include any significant changes in the manner of our use of the assets or the strategy of our overall business, significant negative industry or economic trends and significant decline in our share price for a sustained period.

Upon determination that the carrying value of a long-lived asset may not be recoverable based upon a comparison of aggregate undiscounted projected future cash flow to the carrying amount of the asset, an impairment charge is recorded for the excess of fair value over the carrying amount. We measure fair value using discounted projected future cash flow.

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 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 carry forwards. Our financial statements contain 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.

Stock-based compensation. We account for stock-based compensation in accordance with the provisions of SFAS No. 123 (R), "Share-Based Payment" Under the fair value recognition provisions of SFAS No. 123 (R), stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period of the award. Determining the appropriate fair value model and calculating the fair value of stock-based awards, which includes estimates of stock price volatility, forfeiture rates and expected terms, requires judgment that could materially impact our operating results.

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,		
	2007	2006	2005
Inflation (deflation)	3.4%	(0.1%)	2.5%
Devaluation (Revaluation)	(9.0%)	(8.2%)	(7.5%)
Inflation (devaluation) gap	12.4%	8.1%	10.0%

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 NIS against the US Dollar, or if the timing of such devaluations were to lag considerably behind inflation. Conversely, such costs may, in US Dollar terms, decrease if the rate of inflation is lower than the rate of devaluation of the NIS against the US Dollar.

Organizational Structure

The following is a list of all our subsidiaries, including the name, country of incorporation or residence, and the proportion of our ownership interest in each.

Name of Subsidiary	Country of Incorporation	Percentage of Ownership Interest
Advanced Vision Technology AVT (Germany) GmbH	Germany	100%
Advanced Vision Technology Inc	USA	100%
Advanced Vision Technology Holdings Scrl	Belgium	100%
Graphics Microsystems Inc	USA	100%
Graphics Microsystems NV	Belgium	100%

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

Operating Results

The following table sets forth selected consolidated statements of income data for each of the years ended December 31 2007, 2006 and 2005 in thousands US Dollars outlining the contribution of AVT and GMI to the consolidated statements:

US Dollars in thousands (except per share amounts)

	2007			2006	2005
	Consolidated	GMI	AVT	AVT	AVT
Revenues	39,884	7,506	32,378	28,469	25,143
Cost of revenues	16,868	4,368	12,500	10,839	9,671
Gross profit	23,016	3,138	19,878	17,630	15,472
Gross margin in %	57.7%	41.8%	61.4%	61.9%	61.5%
Operating expenses:					
Research and development, net	6,374	1,874	4,500	3,492	3,011
Selling and marketing	9,888	1,821	8,067	6,605	6,019
General and administrative	4,709	964	3,745	3,018	2,443
Acquired In Process R&D	1,137	1,137	-	-	-
Total operating expenses	22,108	5,796	16,312	13,115	11,473
Operating income/(loss)	908	(2,658)	3,566	4,515	3,999
Financial income, net	2,844	41	2,803	1,231	30
Profit before taxes on income	3,752	(2,617)	6,369	5,746	4,029
Taxes on income (tax benefit)	(1063)	(774)	(289)	332	(172)
Net income/(loss)	4,815	(1843)	6,658	5,414	4,201

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

The following table sets forth selected consolidated statements of income (excluding GMI's results) data for each of the three years ended December 31, 2007, 2006 and 2005 expressed as a percentage of total revenues:

US Dollars in thousands (except per share amounts)

	2007	2006	2005
Revenues	100%	100%	100%
Products	92.1	92.8	94.5
Services	7.9	7.2	5.5
Cost of revenues	38.6	38.1	38.5
Gross profit	61.4	61.9	61.5
Operating expenses			
Research and development, gross	15.1	13.4	13.2
Less-grants	(1.2)	(1.1)	(1.2)
Selling and marketing	24.9	23.2	23.9
General and administrative	11.6	10.6	9.7
Total operating expenses	50.4	46.1	45.6
Operating income	11.0	15.8	15.9
Financial income, net	8.7	4.4	0.1
Profit before taxes on income	19.7	20.2	16.0
Taxes on income (tax benefit)	(0.9)	1.2	(0.7)
Net income	20.6	19.0	16.7

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

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

The following table sets forth selected proforma consolidated statements of income data (excluding GMI's results and stock-based compensation expense) for each of the years ended December 31 2007, 2006 and 2005 in thousands US Dollars:

US Dollars in thousands (except per share amounts)

	2007			2006	2005
	GAAP	Stock-based compensation	Non GAAP	Non GAAP	Non GAAP
Revenues	32,378		32,378	28,469	25,143
Cost of revenues	12,500	108	12,392	10,788	9,669
Gross profit	19,878	108	19,986	17,681	15,474
Gross margin in %	61.4%		61.7%	62.1%	61.5%
Operating expenses					
Research and development, net	4,500	123	4,377	3,439	3,005
Selling and marketing	8,067	174	7,893	6,503	6,009
General and administrative	3,745	310	3,435	2,642	2,422
Total operating expenses	16,312	607	15,705	12,584	11,436
Operating income	3,566	715	4,281	5,097	4,038
Financial income, net	2,803		2,803	1,231	30
Profit before taxes on income	6,369	715	7,084	6,328	4,068
Taxes on income (tax benefit)	(289)		(289)	332	(172)
Net income	6,658	715	7,373	5,996	4,240

Year ended December 31, 2007, compared with year ended December 31, 2006.

2007 was a transition year. The acquisition of Graphics Microsystems Inc on October 1, 2007 enabled us to penetrate new market segments and offer innovative technology. We are proud to present our success and achievements in 2007 and look forward to continue the growth trend into 2008.

Our 2007 financial statements consolidate the results of operation of Advanced Vision Technology (AVT) for the period January 1, thru December 31, 2007 and the results of operation of Graphics Microsystems (GMI) for the period October 1, thru December 31, 2007.

GMI's revenues for the fourth quarter of 2007 totaled $7,506 thousand with a gross margin of 41.8%. EBIT for the quarter was $(2,658) thousand and net loss was $(1843) thousand. Amortization of intangibles related to the acquisition of GMI was $2,230 thousand. The amortization may be divided to amortization of Technology, Customer Relationship and Trade Marks of $395 thousand, amortization of Order Back-Log of $698 thousand and amortization of In Process Research and Development of $1,137 thousand.

Technology, Customer Relationship and Trade Marks will amortize ratably over the next 7-10 years. 50% of Order Back-Log was amortized during the fourth quarter of 2007 and the remainder will amortize at the first quarter of 2008. In Process Research and Development was written off at the date of closing.

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

GMI's proforma gross margin for the quarter (excluding amortization of Technology) was 46.5%. Proforma EBIT (excluding amortization of intangibles) for the fourth quarter totaled $(428) thousand and proforma net income was $387 thousand. EBITDA for the quarter totaled $(264) thousand. GMI's order booking for Q4 2007 totaled $6,868 thousand and Order Back-Log as of December 31, 2007 was $12,098 thousand.

During the fourth quarter of 2007 we adjusted GMI's revenue recognition and other accounting policies to the AVT policies and practices. GMI's operating results incorporates the changes in policies and practices.

The following table sets forth selected GMI stand alone restated statements of income data for each of the years ended December 31, 2007 and 2006 in thousands US Dollars. The statements of income data exclude amortization of intangibles derived from the acquisition of GMI.

	Year ended December 31,		
	2007	2006	%
Revenues	32,753	29,107	12.5
Cost of revenues	17,404	15,845	9.8
Gross profit	15,349	13,262	15.7
	46.9%	45.6%	
Operating expenses			
Research and development, gross	6,389	5,383	18.7
Selling and marketing	4,001	4,256	(6.0)
General and administrative	4,037	3,796	6.3
Total operating expenses	14,427	13,435	7.4
Operating income	922	(173)	
	2.8%	(0.6)%	
EBITDA	1,599	531	
	4.9%	1.8%	

Revenues increased in 2007 12.5% over 2006 revenues with a slight increase in gross margin from 45.6% in 2006 to 46.9% in 2007. The Revenues increase is attributable to revamping the product line and the success in addressing outstanding warranty issues at the end of 2006.
Research and development expenses increased 18.7% year on year representing the investment in the development of the new newspaper closed loop color control solutions.
General and administrative expense increased in 2007 by 6.3% over 2006 attributable to the increase in the volume of business. While revenues increased in 2007 by 12.5% operating expenses increased by only 7.4% at this period, representing a significant improvement in operating profitability. EBIT increased from (0.6)% in 2006 to 2.8% in 2007 while EBITDA increased from 1.8% to 4.9% respectively.

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

The following Management Discussion and Analysis refers to the results of the AVT operation (excluding GMI).

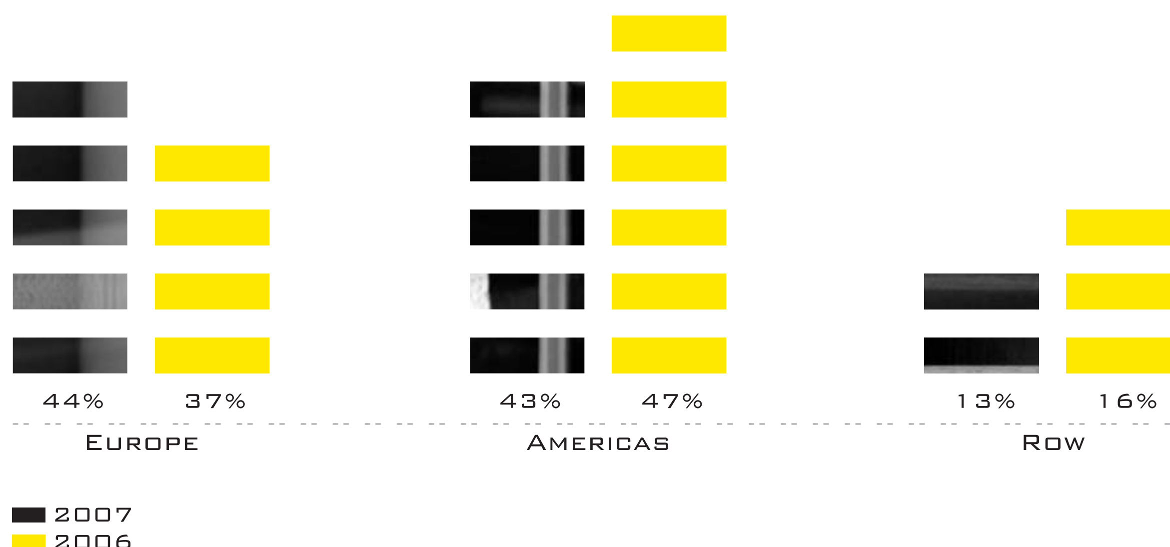
Revenues

Revenues are derived primarily from the sale of our systems. Additional revenues are generated through the sale of support services, training and software updates to customers. Revenues in 2007 totaled $32,378 thousand representing an increase of 13.7% over the revenues of 2006. 2007 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 worldwide. During 2007 we continued the penetration into the Labels market. Revenues from our labels products accounted for approximately 30% of our annual revenues compared with 27% of revenues in 2006.

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 2007 totaled $2,548 thousand (out of the total revenues of $32,378 thousand) 24.6% higher than the $2,045 thousand generated in 2006. 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 2007 were $2,765 thousand 13.2% higher than in 2006. The service orders, not yet recognized as revenues, will be recognized ratably over the contractual period. During 2007 order booking totaled $33,640 thousand representing an increase of 16.6% over 2006 order booking of $28,858 thousand. The ratio of order booking to revenues in 2007 was 104% demonstrating our growth and improved visibility. As of December 31, 2007 order back-log totaled $10,939 thousand an increase of 16.5% over the balance at December 31, 2006, 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 2008, while the remainder will become revenue in the proceeding three quarters.

The increase in order booking is attributable to the good 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, 2007 and 2006:



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

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.

Gross margin changed slightly from 61.9% in 2006, to 61.4% in 2007. 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.

The following table sets forth selected proforma consolidated expenditures data (excluding stock-based compensation expense) for each of the five quarters ended 31.12.2007, 30.9.2007, 30.6.2007, 31.3.2007 and 31.12.2006 expressed as a percentage of total revenues.

	Cost of Revenues	Gross R&D	Selling & Marketing	General & Administrative
Q4/06	40.1%	13.6%	23.4%	9.1%
Q1/07	37.8%	13.3%	24.2%	9.6%
Q2/07	36.2%	13.9%	22.9%	8.2%
Q3/07	37.6%	14.3%	23.7%	10.9%
Q4/07	41.4%	17.4%	27.8%	12.3%

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.

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

In 2007, gross research and development expenses totaled $4,903 thousand, 28.8% higher than 2006 ($3,808 thousand). This increase is primarily attributable to the development of solutions to the sheet fed market and to the acceleration in R&D activities towards Drupa in May 2008.
R&D expenses were partially offset by certain government grants. In 2007, total government grants due were $403 thousand compared with $316 thousand received for 2006. The funds available for Office of the Chief Scientist grants, out of the annual budget of the State of Israel, were reduced in recent years, and the Israeli authorities have indicated in the past that the government may further reduce or abolish Office of the Chief Scientist grants in the future. Even if these grants are maintained, we cannot presently predict what would be the amounts of future grants, if any, that we might receive.

Selling and Marketing Expenses

In 2007, selling and marketing expenses increased by 22.1% compared to 2006. The increase is attributable to the increase in selling expenses and marketing activities related to the high volume of orders booked during the year.

General and Administrative Expenses

General and administrative expenses increased by 24.1% in 2007. The increase is mostly attributable to a one off $360 thousand business development expense incurred during the third quarter of 2007. Proforma expenses (excluding the above mentioned business development expense and stock-based compensation expense) increased by only 16.4% compared with 2006.

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 2007 was $715 thousand.

Operating and Net Income

Net income for the full year ended December 31, 2007 was $6,658 thousand, or $1.24 per share (diluted) compared with a net income of $5,414 thousand for 2006, or $1.13 per share (diluted). Proforma operating income for 2007 (excluding amortization of deferred stock-based compensation expense and the one off business development expense) decreased from a profit of $5,097 thousand in 2006 to a profit of $4,641 thousand in 2007 representing a decrease of 8.9%. Proforma operating income represented 17.9% of revenues in 2006 compared with 14.3% of revenues in 2007. Proforma EBITDA for 2007 (excluding stock-based compensation expense and the one off business development expense) decreased by 7.5% from a profit of $5,334 thousand in 2006 to a profit of $4,934 thousand.
The decrease in proforma EBIT and proforma EBITDA is mostly attributable to the devaluation of the US Dollar to the Israeli currency by 9% and to the Euro by 11.4%, increasing the Dollar value of expenses denominated in these currencies. The increase in operating expenses was partially offset by the increase in financing income attributable to the above mentioned devaluation of the US Dollar. Proforma income before taxes (excluding amortization of deferred stock-based compensation expense and the one off business development expense) may demonstrate the elimination of the devaluation of the US Dollar that had contradictory impact on operating expenses and financing income. In 2007 proforma income before taxes was $7,444 thousand an increase of 17.6% compared with 2006, representing 23% of revenues compared with 22.2% in 2006.

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

Financial Income, net

Net financial income in 2007 was $2,844 thousand compared with $1,231 thousand in 2006. 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 2007 and is offsetting certain increases in other operating expenses denominated in the Israeli currency and Euro.

Financial income for 2007 accounted for $1,619 thousand compared to $913 thousand for 2006, added to exchange rate differences and other interest and bank charges of $1,184 thousand during 2007.

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 2006 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
(analysis of consolidated figures)

As of December 31, 2007 we had approximately $16.7 million of cash and cash equivalents, short and long-term investments compared with $31.7 million at December 31, 2006. The decrease in cash during 2007 is due to the consideration of $33 million paid for the acquisition of GMI.

In 2007, $8,098 thousand were provided by operating activities compared with $6,209 thousand in 2006. The increase in cash, provided from operating activities, is attributable to the increase in turn over and profitability. Net cash provided by financing activities during 2007 totaled $10,165 thousand mostly from the issuance of treasury shares at the beginning of the year.

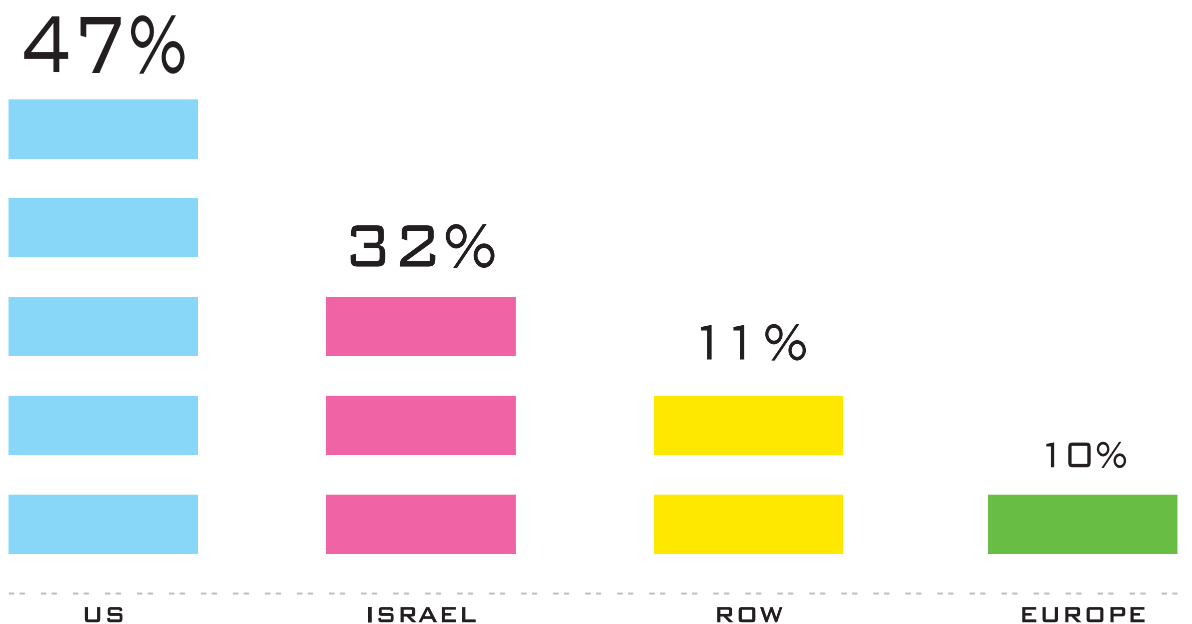
Our inventory balance is net of old and slow inventories that were written off during 2007. The balance represents the level of inventory necessary to facilitate our current production level. We focus on managing our working capital, particularly in maintaining the relative low level of Accounts Receivable Days Sales Outstanding (DSO) and inventories. DSO in accounts receivable for 2007 was 55 days compared with 59 days at the end of 2006, excluding the contribution of GMI to DSO we had 59 days for AVT same as at the end of 2006. Our 2007 capital expenditures on fixed assets were $455 thousand compared with $407 thousand used during 2006. As of December 31, 2007 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, 2007, 309 people were employed by us worldwide. 173 people were employed by GMI worldwide and 136 people were employed by AVT worldwide compared with 123 employed by AVT at December 31, 2006. 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, 2007 and 2006, and the related consolidated statements of income, changes in shareholders' equity and cash flow for each of the three years in the period ended December 31, 2007. 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, 2007 and 2006, and the consolidated results of their operations and their cash flow for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2n to the consolidated financial statements, in 2006 the Company adopted Statement of Financial Accounting Standards Board No. 123 (revised 2004) "Share-Based Payment", as revised, effective January 1, 2006.

Kost, Forer Gabbay and Kasierer

Tel-Aviv, Israel
April 30, 2008

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

Consolidated Balance Sheets

	U.S. Dollars in thousands December 31,	
	2007	2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 16,653	$ 22,227
Available for sale marketable securities	-	1,019
Held to maturity marketable securities	-	7,493
Trade receivables (net of allowance for doubtful accounts of $206 and $129 as at December 31, 2007 and 2006, respectively)	9,499	4,798
Inventories	6,168	2,681
Other accounts receivable and prepaid expenses	3,415	1,896
Deferred income taxes	2,191	-
Total current assets	37,926	40,114
LONG-TERM ASSETS:		
Held to maturity marketable securities	-	1,000
Deferred income taxes	697	337
Severance pay fund	1,835	1,459
Total long-term assets	2,532	2,796
PROPERTY AND EQUIPMENT, NET	2,096	650
INTANGIBLE ASSETS:		
Other intangible assets, net	11,908	-
Goodwill	19,237	825
Total intangible assets	31,145	825
Total assets	$ 73,699	$ 44,385

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, 2007	December 31, 2006
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 1,942	$ 934
Employees and payroll accruals	3,992	1,467
Customer advances and deferred revenue	6,971	1,787
Accrued expenses and other liabilities	6,296	2,650
Total current liabilities	19,201	6,838
LONG-TERM LIABILITIES:		
Deferred income taxes	1,228	-
Accrued severance pay	2,942	2,282
Total long-term liabilities	4,170	2,282
SHAREHOLDERS' EQUITY:		
Share capital:		
Ordinary shares of New Israeli Shekels (NIS) 2 par value: 30,000,000 and 7,013,500 shares authorized at December 31, 2007 and 2006, respectively; 6,296,898 shares issued at December 31, 2007 and 2006; 5,255,470 and 4,538,796 shares outstanding at December 31, 2007 and 2006, respectively	3,402	3,402
Additional paid-in capital	60,446	55,303
Treasury shares at cost - 1,041,428 shares and 1,758,102 shares as of December 31, 2007 and 2006, respectively	(8,776)	(14,815)
Accumulated other comprehensive income	-	26
Accumulated deficit	(4,744)	(8,651)
Total shareholders' equity	50,328	35,265
Total liabilities and shareholders' equity	$ 73,699	$ 44,385

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

Consolidated Statements of Income

U.S. Dollars in thousands (except per share amounts)
Year ended December 31,

	2007	2006	2005
Revenues	39,884	28,469	25,143
Cost of revenues	16,868	10,839	9,671
Gross profit	23,016	17,630	15,472
Operating expenses:			
Research and development	6,777	3,808	3,323
Less - grants	(403)	(316)	(312)
Selling and marketing	9,888	6,605	6,019
General and administrative	4,709	3,018	2,443
Acquired in-process research and development	1,137	-	-
Total operating expenses	22,108	13,115	11,473
Operating income	908	4,515	3,999
Financial income, net	2,844	1,231	30
Income before taxes on income	3,752	5,746	4,029
Taxes on income (tax benefit)	(1,063)	332	(172)
Net income	$ 4,815	$ 5,414	$ 4,201
Basic earnings per ordinary share	$ 0.95	$ 1.20	$ 0.96
Diluted earnings per ordinary share	$ 0.90	$ 1.13	$ 0.90

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, 2005	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 granted to employees	-	(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
Issuance of treasury shares upon 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
Adoption of FASB interpretation No. 48	-	-	-	-	-	(622)		(622)
Balance as of January 1, 2007 as adjusted	3,402	55,303	-	(14,815)	26	(9,273)		34,643
Issuance of treasury shares upon exercise of options	-	-	-	856	-	(286)		570
Sale of treasury shares through private placement	-	4,412	-	5,183	-	-		9,595
Stock-based compensation related to options granted to employees	-	731	-	-	-	-		731
Realized gain on available for sale marketable securities	-	-	-	-	(26)	-	(26)	(26)
Net income	-	-	-	-	-	4,815	4,815	4,815
							4,789	
Balance as of December 31, 2007	3,402	60,446	-	(8,776)	-	(4,744)		50,328

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

Consolidated Statements of Cash Flow

	U.S. Dollars in thousands Year ended December 31,		
	2007	2006	2005
Cash flow from operating activities:			
Net income	4,815	5,414	4,201
Adjustments to reconcile net income to net cash provided by operating activities:			
Stock-based compensation related to options granted to employees	731	582	39
Realized loss on marketable securities, net	135	-	-
Depreciation of property and equipment	457	237	215
Amortization of intangible assets	1,093	-	57
Acquired in-process research and development	1,137	-	-
Amortization of marketable debt securities premium and accretion of discount	(7)	4	51
Decrease (increase) in trade receivables, net	364	(377)	(915)
Increase in other accounts receivable and prepaid expenses	(893)	(380)	(6)
Decrease (increase) in inventories	(618)	(219)	738
Deferred income taxes	(1,761)	-	(337)
Decrease in trade payables	(898)	(108)	(8)
Increase in employees and payroll accruals	1,255	214	124
Increase in customer advances, accrued expenses and other liabilities	2,139	708	113
Increase in accrued severance pay, net	284	134	179
Net cash provided by operating activities	8,233	6,209	4,451
Cash flow from investing activities:			
Proceeds from redemption of marketable securities	8,500	10,235	7,940
Proceeds from sale of available for sale marketable securities	1,406	-	-
Purchase of available for sale marketable securities	(548)	(993)	-
Purchase of held to maturity marketable securities	-	(1,000)	(9,496)
Purchase of property and equipment	(455)	(407)	(160)
Acquisition of GMI, net of cash acquired	(32,875)	-	-
Net cash provided by (used in) investing activities	(23,972)	7,835	(1,716)
Cash flow from financing activities:			
Proceeds from sale of treasury shares	9,595	-	85
Proceeds from exercise of options granted to employees	570	482	45
Net cash provided by financing activities	10,165	482	130
Increase (decrease) in cash and cash equivalents	(5,574)	14,526	2,865
Cash and cash equivalents at the beginning of the year	22,227	7,701	4,836
Cash and cash equivalents at the end of the year	16,653	22,227	7,701

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

Consolidated Statements of Cash Flow

	U.S. Dollars in thousands **Year ended December 31,**
	2007
Acquisition of GMI:	
Estimated net fair value of assets acquired and liabilities assumed at acquisition date:	
Property and equipment	$ 1,448
Technology	9,766
In-process research and development ("IPR&D")	1,137
Customer list	1,405
Back-log	1,396
Trademarks	434
Goodwill	18,412
Working capital, net (excluding cash and cash equivalents)	(685)
Deferred income taxes, net	(438)
	$ 32,875

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

Notes to Consolidated Financial Statements

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

{1} General

a. 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.

In 2007, the Company acquired Graphics Microsystems, Inc ("GMI"), a manufacturer of pressroom equipment engaged in the business of developing, manufacturing and selling of closed loop color control (CLC) systems, color management and reporting software, and remote digital ink fountain control systems to leading commercial printers and press manufacturers worldwide.

b. Acquisition of GMI:

On October 1, 2007, the Company completed the purchase of all outstanding shares of GMI and the related intellectual property which was held by another entity under the seller's control, for a total consideration of $33,527 in cash (including transaction costs of $527).

The acquisition has been accounted for using the purchase method of accounting in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141 "Business Combinations". The purchase price has been allocated to the assets acquired and liabilities assumed based on their estimated fair value at the date of acquisition. The excess of the purchase price over the estimated fair value of the tangible and intangible assets acquired has been recorded as goodwill.

The Company has allocated the total purchase price as follows:

Allocation of purchase price	Value at October1, 2007	Estimated usefull life
		Years
Working capital, net (1)	(33)	
Property and equipment (1)	1,448	
Technology	9,766	
In-process research and development ("IPR&D")	1,137	7
Customer list	1,405	
Backlog	1,396	10
Trademarks	434	0.5
Goodwill (1)	18,412	10
Deferred income taxes, net (1)	(438)	
Total Purchase price	33,527	

(1) The allocation made is preliminary and may be subject to subsequent adjustments

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

Current assets and liabilities were recorded at their carrying amounts. The carrying amounts of the current assets and liabilities approximates their market values due to their short-term maturity. Property and equipment were presented at current replacement cost.

The fair value of intangible assets was based on a valuation conducted by a third party valuation firm using the income approach. The valuation is based on estimates and assumptions provided by management.

Customer relationships and backlog represent the underlying relationships and agreements with GMI's installed customer base.

Technology represents a combination of GMI's processes, patents and trade secrets related to the design and development of its products.

Trade names value represents the name recognition value of GMI's brand name as the result of advertising expenditures for customer relations and the technological development to provide consistent, leading edge products and a strong research and development commitment by the Company.

The Company expensed in-process research and development ("IPR&D") in the amount of $1,137 upon acquisition as it represents incomplete research and development projects that had not reached technological feasibility and had no alternative future use as of the date of the acquisition. The value assigned to IPR&D was determined by considering the importance of the project to the Company's overall development plan, estimating the costs to develop the purchased IPR&D into commercially viable products and the resulting net cash flow from the project when completed and discounted its present value based on the percentage of completion of the IPR&D projects.

The following unaudited condensed combined pro forma financial information presents the Company's adjusted results of operations as if the acquisition had occurred as of the beginning of the fiscal years 2007 and 2006, assuming that net income for the periods incorporates the amortization of intangible assets excluding the write-off of acquired IPR&D of $1,137 and includes amortization of intangible assets. The unaudited pro forma financial information does not necessarily reflect the results of operations that would have occurred, and is not necessarily indicative of results which may be obtained in the future:

	Year ended December 31,	
	2007	2006
Pro forma revenues	$ 65,131	$ 57,615
Pro forma net income	$ 1,090	$ 1,900
Pro forma basic earnings per share	$ 0.21	$ 0.42
Pro forma diluted earnings per share	$ 0.20	$ 0.40

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

{2} Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles.

a. Use of estimates:

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

The majority of the Company's revenues is denominated 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 "SFAS" No. 52, "Foreign Currency Translation". Changes in currency exchange rates between the Company's functional currency and the currency in which a transaction is denominated are included in the Company's results of operations as financial income (expense) in the period in which the currency exchange rates change.

c. Principles of consolidation:

The consolidated financial statements include the financial statements of the Company 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. Investments in 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".

Management determines the appropriate classification of its investments in marketable 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. Securities classified as available for sale are carried at fair value, with the unrealized gains and losses, net of tax, reported in "Accumulated other comprehensive income" in shareholders' equity.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity based on the affective interest method. Dividend and interest income, including amortization of the premium and discount arising at acquisition, are included in financial income, net.

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

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 volumes. 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(mainly 33)
Machinery and equipment	6 – 20 (mainly 20)
Office furniture and equipment	6 – 20 (mainly 6)
Leasehold improvements	The shorter of the term of the lease
	or the useful life of the asset

h. Goodwill:

Goodwill represents the excess of the purchase price in a business combination over the fair value of the net assets acquired. 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. SFAS 142 prescribes a two phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment.

In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

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

Fair value of a reporting unit is determined using the discounted future cash flow method. Significant estimates used in the methodology include estimates of future cash flow, future short-term and long-term growth rates and weighted average cost of capital for each of the reporting units.

The Company identified two reporting unit based on the guidance of SFAS 142. For each of the three years in the period ended December 31, 2007, no impairment losses have been identified.

i. Intangible assets:

The intangible assets are stated at cost, net of accumulated amortization. The intangible assets are amortized using the straight-line method over their estimated useful life. Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset is reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates.

The amortization expense on intangible assets is recognized in the income statements in the expense category consistent with the function of the intangible asset.

As of December 31, 2007, no impairment losses or changes in useful life have been recorded.

j. Research and development costs:

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

k. Revenue recognition:

The Company and its subsidiaries derive their revenues from selling their products to end users and to printing press manufacturers through Original Equipment Manufacturer ("OEM") partners. The Company also generates revenues from maintenance, support and repair services related to these sales.

Revenues from product sales are recognized in accordance with SEC Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition" ("SAB 104"), when delivery has occurred, persuasive evidence of an arrangement exists, the vendor's fee is fixed or determinable, no future obligation exists and collectibility is probable.

The Company generally does not grant a right of return to its customers. When sale arrangements include a customer acceptance provision with respect to products, revenue is not recognized before the Company has demonstrated that the criteria specified in the acceptance provisions have been satisfied, or that the acceptance provision has lapsed.

In cases where the arrangement involves the delivery of products and post delivery installation services that are not essential to the functionality of the equipment, the Company's follow the requirements set forth in Emerging Issues Task Force ("EITF") Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"), relating to the separation of multiple deliverables into individual accounting units. Revenue from such deliverables is recognized in accordance with SAB 104.

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

In arrangements which include multiple elements, the Company considers the sale of equipment and its installation to be two separate units of accounting in the arrangement, since the installation is not essential to the functionality of the equipment, the equipment has value to the customer on a standalone basis, and fair value of the installation services exists. The Company defers the fair value of the installation service (but not less than the amount contingent upon completion of installation, if any) to the period in which such installation occurs.

Deferred revenues include amounts received from customers for which revenue has not been recognized.

l. 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 in the amount of such costs at the time revenue from the product sale is recognized. Changes in the Company's provision for warranty during the respective years are as follows:

	2007	2006
Balance, beginning of year	559	548
Warranties assumed as part of business combination	210	-
Warranties utilized and expired during the year	(672)	(548)
Warranties issued during the year	792	559
Balance, end of year	889	559

m. Concentrations of credit risk:

Financial instruments that potentially subject the Company and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables.

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 trade receivables are derived from sales to customers located primarily in the United States and Europe. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. In certain circumstances, the Company may require letters of credit or other collateral. An allowance for doubtful accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection. As of December 31, 2007 and 2006, the allowance for doubtful accounts amounted to $206 and $129, respectively. To date, the Company has not experienced any material losses on its accounts receivable. The risk of collection associated with accounts receivable is mitigated by the diversity and number of customers.

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

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

n. 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 periods beginning at January 1, 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 123R. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

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.

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

	Year ended December 31,
	2005
Net income as reported	$ 4,201
Add - stock-based employee compensation - intrinsic value included in reported net income	39
Deduct - stock-based employee compensation - fair value	(539)
Pro forma net income	$ 3,701
Basic earnings per share, as reported	$ 0.96
Diluted earnings per share, as reported	$ 0.90
Pro forma basic earnings per share	$ 0.85
Pro forma diluted earnings per share	$ 0.81

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

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:

	Year ended December 31,		
	2007	2006	2005
Risk-free interest rate	4.96%	3.78%	3.5%
Suboptimal exercise multiple	3	3	-
Forfeiture rate	8.44%	8.67%	16.67%
Dividend yield	-	-	-
Expected volatility	39%	54%	55%
Weighted average expected life (years)	-	-	5.32

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 distribute dividends.

o. 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 unrealized gains and losses on available for sale securities.

p. Treasury stock

On June 27, 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 upon exercise of options. When treasury shares are 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.

q. 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.

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

Research and development grants recognized amounted to $403, $316 and $312 in 2007, 2006 and 2005, respectively. Total royalties accrued or paid amounted to $1,126, $996 and $881 in 2007, 2006 and 2005, respectively and were recorded in the cost of revenues.
Total royalties accrued or paid to the Fund for the Encouragement of Marketing Activities amounted to $0, $0 and $76 in 2007, 2006 and 2005, respectively, and were recorded as selling and marketing expenses.

r. 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).

s. Severance pay:

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

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

Severance expense for the years ended December 31, 2007, 2006 and 2005 amounted to $660, $398 and $288, respectively.

t. Basic and diluted net 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".

u. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with SFAS 109, “Accounting for Income Taxes” (“SFAS 109”). This statement prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to amounts more likely than not to be realized.

Deferred tax liabilities and assets are classified as current or non current based on the classification of the related asset or liability for financial reporting, or according to the expected reversal dates of the specific temporary differences if not related to an asset or liability for financial reporting.

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

Effective January 1, 2007, the Company adopted FASB Interpretation No 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS 109. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. As a result of this adoption, we recognized a charge of approximately $622 to the January 1, 2007 retained earnings balance. The Company accrues interest and penalties related to unrecognized tax benefits in its financial expenses.

v. Impact of recently issued accounting pronouncements:

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The FASB issues a FASB Staff Position (FSP) to defer the effective date of SFAS No.157 for one year for all nonfinancial assets and nonfinancial liabilities, except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company is currently assessing the impact that SFAS 157 will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). SFAS 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. SFAS 159 requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, although earlier adoption is permitted. As the Company has no financial instruments or certain other items at fair value at the adoption date of SFAS 159, the Company has not yet elected the fair value option for any item permitted under SFAS 159.

In December 2007, the FASB issued SFAS No. 141 (Revised) "Business Combinations". SFAS 141 (Revised) replaces SFAS 141 "Business Combination" and establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. SFAS 141 also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The guidance will become effective for the fiscal year beginning after December15, 2008. The Company does not expect that SFAS 141 (Revised) will have any significant impact on the Company's historical financial statements upon adoption.

In December 2007, the FASB issued SFAS 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS 160"). SFAS 160 amends Accounting Research Bulletin 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements.

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

SFAS 160 also changes the way the consolidated income statement is presented by requiring consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent owners and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for financial statements issued for fiscal years on or after December 15, 2008, and interim periods within those fiscal years. The Company does not expect that SFAS 160 will have any significant impact on the Company's historical financial statements upon adoption.

{3} Marketable Securities

As of December 31, 2006, the Company's securities were classified as available for sale and held-to-maturity marketable securities. As of December 31, 2007 the Company had no investments in marketable securities.

The following is a summary of marketable securities:

December 31, 2006

	Cost	Gross unrealized gains	Gross unrealized losses	Market value
Held-to-maturity:				
Government agency	2,493	-	(6)	2,487
U.S. corporate bonds	6,000	-	(27)	5,973
	8,493	-	(33)	8,460
Available for sale:				
Equity securities	993	26	-	1,019

In 2006, 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.

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

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

	December 31, 2006			
	Cost	Gross unrealized gains	Gross unrealized losses	Market value
Due in one year or less	7,493	-	(30)	7,463
Due in one to two years	1,000	-	(3)	997
	8,493	-	(33)	8,460

The unrealized losses on the Company's investments in debt securities were due to interest rate increases. 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 did not consider these investments to be other-than-temporarily impaired as of December 31, 2006.

In October 2007, the Company sold all the available for sale marketable securities for total consideration of $1,406. The Company recorded capital loss of $135.

{4} Other Accounts Receivable and Prepaid Expenses

	December 31,	
	2007	2006
Government grants	156	246
Government authorities	911	701
Accrued interest	29	111
Prepaid expenses	1,858	835
Other accounts receivable	461	3
	3,415	1,896

{5} Inventories

	December 31,	
	2007	2006
Raw materials	2,418	1,135
Work in progress	1,376	980
Finished products	2,374	566
	6,168	2,681

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

{6} Property and Equipment

	December 31,	
	2007	2006
Cost:		
Computers and peripheral equipment	2,123	1,663
Machinery and equipment	1,299	330
Office furniture and equipment	228	171
Leasehold improvements	234	142
	3,884	2,306
Accumulated depreciation:		
Computers and peripheral equipment	1,241	1,242
Machinery and equipment	331	242
Office furniture and equipment	101	85
Leasehold improvements	115	87
	1,788	1,656
Property and equipment	2,096	650

Depreciation expense for the years ended December 31, 2007, 2006 and 2005 was $457, $237 and $215, respectively.

During 2007 and 2006, the Company recorded a reduction of approximately $325 and $0, respectively, to the cost and accumulated depreciation of fully depreciated equipment no longer in use, following an assessment made by the Company.

For liens, see Note 9c.

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

{7} Intangible Assets

	December 31,	
	2007	2006
Cost:		
Technology	9,972	206
Customer list	1,405	-
Backlog	1,396	-
Trademarks	434	-
	13,207	206
Accumulated depreciation:		
Technology & Patents	555	206
Customer Relationships	35	-
Backlog	698	-
Trademarks/Tradenames	11	-
	1,299	206
Intangible assets	11,908	-

Amortization expenses amounted to $1,093, $0 and $57 for the years ended December 31, 2007, 2006 and 2005, respectively.

Estimated amortization expenses for the years ended:

Year	December 31,
2008	2,277
2009	1,579
2010	1,579
2011	1,579
2012 and thereafter	4,894
	11,908

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

{8} Accrued Expenses and Other Liabilities

	December 31,	
	2007	2006
Provision for warranty costs	889	559
Government authorities and tax provision	2,746	1,457
Accrued expenses	2,427	634
Other liabilities	234	-
	6,296	2,650

{9} 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 2016.

Future minimum lease commitments under non-cancelable operating leases as of December 31, 2007, are as follows:

Year	
2008	2,109
2009	1,725
2010	1,097
2011	1,041
2012	1,073
2013 and thereafter	1,409
	8,454

Total rent expenses for the years ended December 31, 2007, 2006 and 2005 amounted to $1,443, $1,063 and $900, 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.

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

As of December 31, 2007, the Company has a contingent obligation to pay royalties in respect of the aforementioned grants in the approximate amount of $2,707.

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.

{10} Income Taxes

a. General

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

b. Israel taxation

1. Corporate tax structure:

   Taxable income of Israeli companies is subject to tax at the rate of 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter. Non-Israeli subsidiaries are taxed based on tax laws in their countries of residence.

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.

   In accordance with the Law, the Company has elected the". Alternative tax benefits" On April 1, 2005, an amendment to the Law came into effect ("the Amendment") and has significantly changed the provisions of the Law. 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 "Privileged Enterprise" (rather than the previous terminology of "Approved Enterprise"), such as by requiring that at least 25% of the "Privileged 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 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 any certificate of approval already granted will remain subject to the provisions of the Law as they were on the date of such approval. Therefore, the Company's existing "Approved Enterprise" will generally not be subject to the provisions of the Amendment. As a result of the Amendment, tax-exempt income generated under the provisions of the amended Law, will subject the Company to taxes upon distribution or complete liquidation.

   Accordingly, Company's income attributed to its "Approved Enterprise" and "Privileged Enterprise" programs 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, depending on the percentage of foreign investment in the Company.
   The duration of tax benefits for the program is subject to limitations of the earlier of 12 years from commencement of investment, or 14 years from receipt of approval as an "Approved Enterprise" under the Law.

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

The entitlement to the above benefits is conditional upon Company's fulfilling the conditions stipulated by the Law, regulations published thereunder and the certificates of approval for the specific investments in "Approved Enterprises". Should the Company fail to meet such requirements in the future, income attributable to its "Approved Enterprise" or "Privileged Enterprise" programs could be subject to the statutory Israeli corporate tax rate, and the Company could be required to refund the tax benefits already received with respect to such program, in whole or in part, including interest.

In the event of distribution of dividend from the above mentioned tax-exempt income, the amount distributed will be subject to corporate tax at the rate ordinarily applicable to the Approved Enterprise's and Privileged Enterprise's income. Out of the Company's earnings available for distribution as of December 31, 2007, $12,874 is tax-exempt attributable to its "Approved Enterprise" program. If such tax-exempt income is distributed in a manner other than upon the complete liquidation of the Company, it would be taxed at the corporate tax rate applicable to such profits and an income tax liability of up to approximately $2,575 would be incurred as of December 31, 2007. The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without imposing tax liability on the Company only upon the complete liquidation of the Company.

The Company has determined that it will not distribute any amounts of its undistributed tax-exempt income as dividend. The Company intends to reinvest its tax-exempt income and not to distribute such income as a dividend. Accordingly, no deferred income taxes have been provided on income attributable to the Company's Approved Enterprise programs as the undistributed tax-exempt income is essentially permanent in duration.
Since part of the Company's taxable income is not entitled to tax benefits under the Law and is taxed at the regular tax rate, its effective tax rate is the result of a weighted combination of the various applicable rates and tax exemptions, and the computation is made for income derived from each program on the basis of formulas specified in the Law and in the approvals.

c. Carryforward tax losses:

As of December 31, 2007, the U.S. subsidiary had U.S. federal carryforward tax losses of approximately $ 2,500 that can be carried forward and offset against taxable income for 15-20 years and expire from 2011-2022. Some of those carried forward losses may not be available due to change in the control of the Company. As of December 31, 2007, the German subsidiary had carryforward tax losses of approximately $2,800, 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:

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. As of December 31, 2007, 2006 and 2005, the Company's deferred taxes were in respect of the following:

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

	Year ended December 31,		
	2007	2006	2005
Deferred tax assets:			
Operating loss carryforwards	1,984	3,466	2,919
Reserves and allowances not currently deductible	2,465	186	513
Total deferred tax asset	4,449	3,652	3,432
Deferred tax liability:			
Identified intangibles	(1,141)	-	-
Depreciation	(87)	-	-
Total deferred tax liability	(1,228)	-	-
Net deferred tax asset before valuation allowance	3,221	3,652	3,432
Valuation allowance	(1,561)	(3,315)	(3,095)
Net deferred tax asset	1,660	337	337
Domestic:			
Current deferred tax asset	555	-	-
Non-current deferred tax asset	477	337	337
	1,032	337	337
Foreign:			
Current deferred tax asset	1,636	-	-
Non-current deferred tax asset	1,781	-	-
Non- current deferred tax liability	(1,228)	-	-
Valuation allowance	(1,561)		
	628	-	-
	1,660	337	337

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

	Year ended December 31,		
	2007	2006	2005
Domestic	9,053	7,803	1,430
Foreign	(5,301)	(2,057)	2,599
	3,752	5,746	4,029

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

g. Taxes on income are comprised as follows:

	Year ended December 31,		
	2007	2006	2005
Current	689	332	(509)
Deferred	(1,752)	-	337
	(1,063)	332	(172)
Domestic	(306)	270	(157)
Foreign	(757)	62	(15)
	(1,063)	332	(172)

h. Reconciliation of the theoretical tax expense:

	Year ended December 31,		
	2007	2006	2005
Income before taxes on income	3,752	5,746	4,029
Statutory tax rate	29%	31%	34%
Theoretical tax at statutory tax rate	1,088	1,781	1,370
Increase (decrease) in respect of:			
Losses, reserves and allowances for which valuation allowance was provided	824	719	24
Utilization of carryforward losses for which valuation allowance was provided in prior years	(303)	(1,290)	(1,064)
Tax adjustment in respect of "Approved Enterprise" status	(3,268)	(1,318)	(566)
Tax adjustment in respect of foreign subsidiaries different tax rates	197	-	-
Stock-based compensation expense	213	180	-
Non-deductible expenses	186	260	64
Actual tax expense (benefit)	(1,063)	332	(172)

i. The Company and its subsidiaries file income tax returns in Israel, United States and various foreign jurisdictions. Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" ("FIN 48"). The balance at December 31, 2007, includes a liability for unrecognized tax benefits of $2,169 for tax positions which are uncertain of being sustained. Since the Company had a full provision for some of these positions prior to January 1, 2007, no adjustments were required for certain positions upon the initial implementation of FIN 48. The accruals are with respect to the eligibility of certain profits to the reduced tax rates under the Company's Approved Enterprise programs, taxation of certain of the Company's income under foreign jurisdictions as well as certain limitation of the utilization of carry forward losses.

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

The Company recognizes interest accrued related to unrecognized tax benefits as financial expenses. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance as of January 1, 2007	1,516
Additions based on tax positions related to the current year	-
Additions for tax positions of prior years	653
Reductions for tax positions of prior years	-
Settlements	-
Balance as of December 31, 2007	2,169

The Company and its subsidiaries are routinely examined by various taxing authorities. The Company's tax years 2005 through 2007 remain subject to examination by the Israeli Tax Authorities.
There are tax years which remain subject to examination in various other jurisdictions that are not material to the Company's financial statements.

{11} Share Capital

a. General:

Ordinary shares confer upon their holders the right to receive notice to participate and vote in general meetings of the Company, and the right to receive dividends if declared.

The Company's board of directors has determined that it will not distribute any amounts of its undistributed tax exempt income as dividend.

b. 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 $8.5 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 101,674 and 124,650 treasury shares were issued to employees in 2007 and 2006, respectively as result of exercise of options made by those employees, 615,000 treasury shares were issued in 2007 to new shareholder at $9,595 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. As of December 31, 2007 and 2006, the Company is holding 1,041,428 and 1,758,102 treasury shares, respectively.

c. 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

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

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.

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

As of December 31, 2007, 327,084 options are available for future grants.

A summary of the stock option activities in 2007 is as follows:

	Amount	Weighted average exercise price	Weighted average remaining contractual life	Aggregate Intrinsic value
Outstanding at January 1, 2005	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		
Granted	253,000	13.77		
Exercised	(101,674)	4.94		
Forfeited	(218,125)	7.54		
Outstanding at December 31, 2007	559,405	9.34	5.79	$ 3,475
Vested and expected to vest at December 31, 2007	496,884	9.00	3.13	$ 3,253
Exercisable at December 31, 2007	246,155	5.72	5.21	$ 2,396

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

As of December 31, 2007, $1,684 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.35 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 2007 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, 2007.

The weighted-average grant-date fair value of options granted during the years 2007, 2006 and 2005 was $7.16, $7.35, and $5.74, respectively. The total intrinsic value of options exercised during the years ended December 31, 2007, and 2006, was $1,052 and $1,768, respectively.

Following are the outstanding options by exercise price as of December 31, 2007:

	Outstanding			Exercisable		
Exercise prise	Number Outstanding	Weighted average remaining contractual life (Years)	Weighted average exercise price	Number exercisable	Weighted average remaining contractual life (Years)	Weighted average exercise price
-	78,071	6.95	-	22,571	2.81	-
2.12	2,500	4.48	2.12	2,500	4.48	2.12
4.08-4.35	107,834	4.94	4.35	107,834	4.94	4.35
6.84-7.54	59,500	6.39	6.96	57,250	6.40	6.97
8-8.57	40,500	5.79	8.03	32,000	6.44	8.04
11-11.39	39,000	4.07	11.15	14,000	4.21	11.14
12.16-12.58	19,000	7.95	12.25	10,000	7.92	12.16
15.41-15.75	183,000	5.75	15.48	-	-	-
17.10	30,000	5.78	17.10	-	-	-
	559,405	5.79	9.34	246,155	5.21	5.72

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

	Year ended December 31,		
	2007	2006	2005
Cost of revenues	108	51	2
Research and development	123	53	6
Selling and marketing	174	102	10
General and administrative	326	376	21
Total stock-based compensation expense	731	582	39

d. As of December 31, 2007, 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.

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

{12} Earnings Per Share

The following table sets forth the computation of basic and diluted Earnings Per Share ("EPS"):

	Year ended December 31,		
	2007	2006	2005
Net income	4,815	5,414	4,201
Weighted average Ordinary shares outstanding - Basic EPS	5,092,696	4,494,079	4,370,771
Dilutive effect:			
Employee stock options	275,896	282,377	291,322
Weighted average Ordinary shares outstanding - Diluted EPS	5,368,592	4,776,456	4,662,093
Basic earnings per share	0.95	1.20	0.96
Diluted earnings per share	0.90	1.13	0.90

The total weighted average numbers of options excluded from the calculation of diluted net earnings per share, as they would have an anti-dilutive effect were 11,160, 11,160 and 13,872 for the years ended December 31, 2007, 2006 and 2005, respectively.

{13} Segment Information

The Company operates in one reporting 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:

	Year ended December 31,		
	2007	2006	2005
Revenues based on the customer's location:			
United States	18,414	13,408	8,284
Europe (other than Germany)	11,487	7,641	7,282
Germany	5,415	3,005	2,940
Other	4,568	4,415	6,637
	39,884	28,469	25,143

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

	December 31, 2007	2006
Long-lived assets by geographic location:		
Israel	1,491	1,417
Europe	59	19
United States	31,691	39
	33,241	1,475

{14} Selected Statements of Operations Data

Financial income, net:

	Year ended December 31, 2007	2006	2005
Financial income:			
Interest	1,388	913	686
Dividend received on marketable securities	368	-	-
Foreign currency translation differences, net	1,305	396	-
	3,061	1,309	686
Financial expenses			
Bank charges	82	78	83
Realized loss on sale of marketable securities	135	-	-
Foreign currency translation differences, net	-	-	500
Other	-	-	73
	217	78	656
	2,844	1,231	30

Report of the Board of Directors

Dear Shareholders,

During 2007 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 developments and material corporate issues related to the company and its subsidiaries.

As of December 31, 2007, the Board of Directors consisted of 4 members, including 3 external Directors. Board meetings focused on strategies for profitable growth through the acquisition of a company whose technologies could complement those of AVT, and which would also open up new market segments to us. Furthermore, we reviewed business development in emerging markets, such as China.

In compliance with the Israel Companies Law, the Board of Directors has an Audit Committee, which consists of 3 Board members, the 2 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 2007, we held 10 Board of Directors meetings, 2 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 by at least 2 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, 2007 and 2006, and the related consolidated statements of income, changes in shareholders' equity and cash flow for each of the three years ended December 31, 2007, were audited by KOST FORER GABBAY & KASIERER, a member of Ernst & Young Global.

In the Audit Committee and Board of Directors meetings held on January 31, 2008, attended by the company's auditors and legal counsel, we discussed the 2007 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, April 30, 2008

Shlomo Amir

Members of the Board of Directors

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.

Dan Falk

Dan Falk served as the President and Chief Operating Officer and then Chief Executive Officer of Sapiens International Corporation N.V., Executive Vice President and Chief Financial Officer of Orbotech, and held senior positions at Israel Discount Bank Ltd., Dan Falk serves as the chairman of the board of directors of Orad High-Tech systems and is a member of the boards of directors of Nice System Ltd., Orbotech Ltd., Ormat Technologies Inc., ClickSoftware Technologies Ltd., Nova Measuring Systems Ltd., Jacada Ltd., Attunity Ltd., DMAtek Ltd., and Plastopil Ltd., He received a master's degree in business administration in 1973 from the Hebrew University School of Business.

Gil Feiler

Gil Feiler is an expert on business development in the Middle East. He serves as a consultant to governments and Fortune 500 corporations, has published numerous books and articles on economic, business and legal issues, and lectures at international events such as the World Economic Forum at Davos and UN conferences. Dr. Feiler established and heads Info-Prod Research (Middle East) Ltd., (www.infoprod.co.il), a business consultancy that provides business matchmaking, market research, risk evaluation, due diligence and risk assessment services. The business news service that he founded provides continual business coverage of the region to the top information companies, including Dow Jones, Reuters, Financial Times, Lexis-Nexis and Gale. Dr. Feiler served as senior lecturer for 15 years at various universities and as director at the Dikla Mutual Fund for 5 years. He holds a Ph.D from Tel Aviv University, Israel.

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