AVT

Advanced Vision Technology Ltd.

Financial Highlights

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

Year ended December 31,	2008	2007	2006
Revenues and Income			
Revenues	60,320	39,884	28,469
Gross profit	26,344	23,016	17,630
Gross margin in %	43.67%	57.77%	61.93%
Research and Development expenses, net	11,206	6,374	3,492
Sales and Marketing expenses, net	13,402	9,888	6,605
General and Administration expenses	8,427	4,709	3,018
Amortization of deferred stock-based compensation	939	731	582
Impairment of goodwill	17,192	-	-
Operating income (loss)	(23,883)	908	4,515
Operating margin in %	(39.59%)	2.28%	15.86%
Net income (loss)	(25,151)	4,815	5,414
Cash flows provided by (used in) operating activities	(2,906)	8,233	6,209
Cash flows provided by (used in) investing activities	(857)	(23,972)	7,835
Cash flows provided by financing activities	215	10,165	482
Balance sheet as of December 31,			
Cash and Equivalents	13,105	16,653	22,227
Total assets	45,015	73,699	44,385
Total liabilities	18,684	23,371	9,120
Total shareholders' equity	26,331	50,328	35,265
Share			
Basic earnings (loss) per share in USD	(4.75)	0.95	1.20
Share price as of December 31,	2.15 Euro	10.50 Euro	11.80 Euro
Employees			
Employees as of December 31,	280	309	123

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Merging Platforms for Growth

The AVT-GMI integration process tests both companies in multiple dimensions. Technological **cross-fertilization**, organizational **optimization**, marketing, sales and support coordination and re-focusing are the key **challenges**. Success will bring significant **achievements**: new offerings, **expanded market** presence and rewards for shareholders.

In 2008, AVT and GMI enthusiastically yet judiciously set out to create “**One Company**” driven by “**One Vision**”.
This effort is demanding discipline, foresight and most of all, employee **motivation and cooperation**. In this Annual Report, we report our roadmap, recording 2008’s milestones and **future integration** plans.

The integration process is taking place during a stormy economic period ruled by uncertainty. However, there are still **opportunities** to be captured and foundations that can be laid for increased **momentum** as the market recovers. At AVT and GMI we are aspiring to merge our intrinsic **technological strengths** and human resources for ever stronger market **leadership**.

Dear Shareholders,

When trying to explain the chain of events that occurred throughout 2008, and the virtual unpredictability of their ramifications, a simple simile can be used: the flapping of a butterfly's wings in China can lead to a change of weather halfway around the globe.

In these combustible times, economic developments change so rapidly that the implications can barely be ingested. The inexorable links that bind the global economy are starkly challenging every nation and virtually every business.

Economic Snapshot
A more regulated and disciplined fiscal environment has to date spared Israel's financial and business sectors from the meltdowns experienced by global leaders. However, Israel's export-driven high-tech sector, in which AVT is a prominent player, is particularly sensitive to economic volatility and downturns in international markets.

Thus, while premiering 2008 on a positive note, the score soon changed, and, similar to other capital equipment vendors, we are finding the market increasingly cautious to invest in capital equipment.
In this venue, we have tuned our marketing messages to focus on cost-savings and customer satisfaction engineered by our solutions. We emphasize that in times where every cost-reduction and every customer can be critical, AVT solutions are right on the mark.

These statements gain particular validity with the presentation, for the first time, of combined AVT-GMI offerings and technologies. Our market leadership is experiencing a vigorous infusion of confidence, as we present what is clearly the next major step of progress on the printer's shop floor. Moreover, our involvement in a growing number of market segments is positioning AVT as a "one source for all" solutions provider.

Fiscal Snapshot
Consolidated revenues for the year ended December 31, 2008 were $60.3 million, as compared to $39.9 million in 2007, an increase of 51.2 percent. Revenues for the fourth quarter of 2008 totaled $11.7 million, a 26% percent decrease) over the same quarter in 2007.

Net loss in 2008 was $25.2 million compared with net profit of $4.8 million in 2007. Fully diluted earnings per share (EPS) for 2008 were a loss of $4.75 per share compared with a profit of $0.90 per share in 2007.
Proforma operating income (excluding non-cash impairment charges and amortization of acquired intangible assets related to GMI's acquisition, stock based compensation expenses and the extraordinary GMI integration costs), decreased by 32.8% in 2008, from a profit of $3.9 million in 2007 to a profit of $2.6 million in 2008.

Fitting It All Together
The year under review was noted for its ambitious strategic and tactical moves to merge AVT and GMI activities at the business, technology, and human resources levels. This is a task in progress, with important milestones achieved during the year, such as the unification of our distribution channels and financial activities. By mid-2009, the major milestones of the merger plan will be accomplished.
I am convinced that we will emerge a stronger, more efficient and innovative company, driven by a common vision and culture.

Showcasing AVT and GMI
Held every four years, the two-week DRUPA trade show for the printing industry brings together printers, suppliers, trade media and analysts from all over the world.

AVT and GMI made their first joint appearance at this milestone show, with five main focus market segments. The displays highlighted new and enhanced AVT and GMI solutions for packaging, labels, folding carton, commercial printing and newspapers applications. This was a visible demonstration of how the AVT-GMI merger signified major benefits for each sector.

In fact, AVT and GMI presented no less than twenty new solutions. Market response was appropriately enthusiastic, with over 1000 solid leads, and a few orders received from North America, Europe and Asia.

The AVT-GMI presence was also highly visible at LabelExpo 2008, where a new generation of the Helios 100% automatic inspection, and MicroColor NW remote ink control solutions were presented for the labels and narrow web markets. The new Helios enables label printers to comply with a variety of barcode standards verification and other requirements.

Still another 2008 showcase performance was achieved at Graph Expo 2008, which focused on commercial heat-set printers. At the show, the next generation of ColorQuick automated closed loop color control system was launched, together with a full automatic 100% web defect detection platform for web-offset commercial printing.

Vote of Confidence
The Ronin Investment Managing Company Ltd. has increased its holdings in AVT to reach approximately 47 percent of the voting rights.

I see Ronin’s move as an expression of confidence in AVT’s management and potential.

A Time for Redoubled Effort
This is a period that tests the mettle of companies: of management, employees and the shareholders to whom they are responsible. We must, side-by-side, constrain costs and unleash innovation, plan cautiously yet act boldly. In this balancing act, we must streamline to weather the downturn, while driving to take advantage of opportunities.

AVT’s employees are of the finest caliber – men and women with the talents and motivation not to be daunted, and we welcome the challenge. AVT’s management is committed to providing the leadership that will help us navigate wisely. Our shareholders can be assured that together, we will leave no stone unturned to maintain their confidence and trust.

Sincerely,

Shlomo Amir
President & 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.

Nadav Yassour, Chief Financial Officer

Mr. Yassour is a senior financial executive with over 20 years of experience in both international corporate finance and early venture development in leading hi-tech companies. Before joining AVT in January 2009, Mr. Yassour served as EVP and Global CFO at Hobart Holdings Ltd. a prominent group of development stage medical device companies, Previously, he served as EVP & CFO of MessageVine Inc., provider of instant messaging systems for global wireless carriers. Prior to that, Mr. Yassour was VP Finance & CFO of InterPharm Laboratories Ltd., RT-SET Ltd. and Leaf Systems Inc. Mr. Yassour started his career at Scitex Corporation where he was the Manager of Corporate Economic and Financial Planning Department. Mr. Yassour holds BA Degree in Economics and Political Science from Haifa University and an MBA from Oregon State University, United States.

Koby Shtaierman

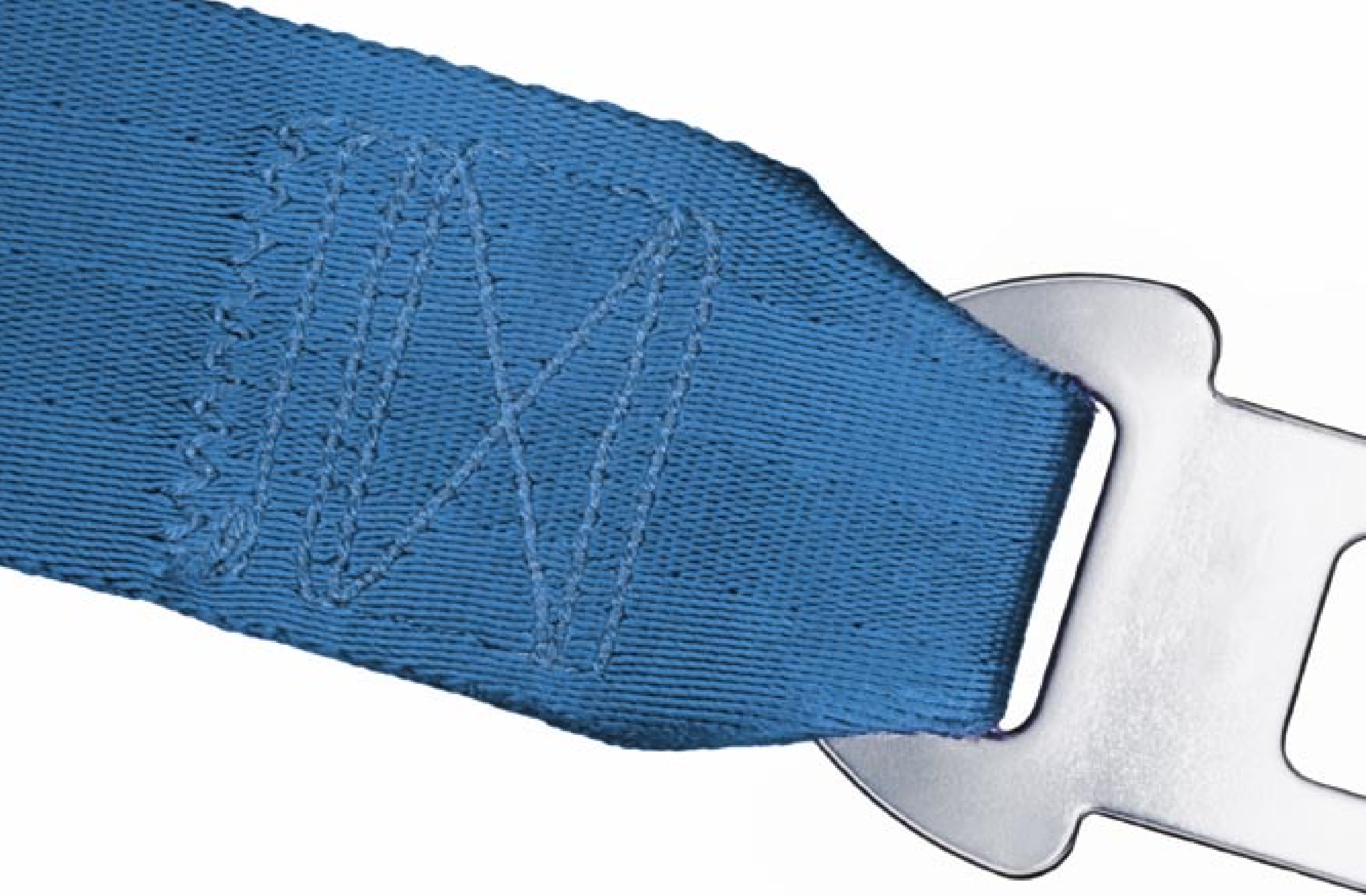
Executive V.P. Corporate Sales and President, AVT Europe

Prior to joining AVT in 1999, Mr. Shtaierman was vice president of marketing at Technomatix, a multinational company headquartered in Israel that developes 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.

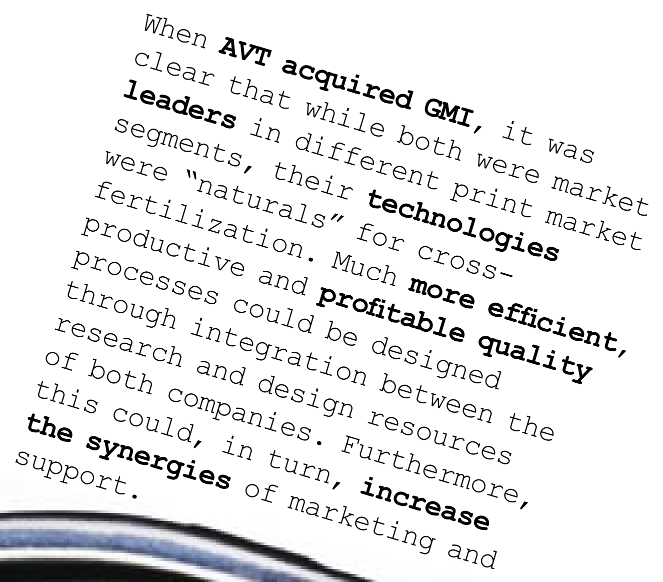
Niki Bassat, V.P. Operations
Mr. Bassat joined AVT from superDimension, a medical device company, where he was Chief Operating Officer and General Manager (Israel). Before that, he was Chief Operating Officer at RaySat, a manufacturer of in-motion satellite antennas. He was the Chief Operating Officer 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, Corporate V.P. Marketing
Mr. 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.



Natural Attraction



When **AVT acquired GMI**, it was clear that while both were market **leaders** in different print market segments, their **technologies** were "naturals" for cross-fertilization. Much **more efficient**, productive and **profitable quality** processes could be designed through integration between the research and design resources of both companies. Furthermore, this could, in turn, **increase the synergies** of marketing and support.

The **development** of these affinities, however, required an **intensive**, coherent and highly **motivated merger process**. Planned to be completed in 2009, during 2008 the merger strategies impacted every level of both companies. Clear mid-term integration objectives were defined, calling for **development** of cross-market **opportunities**, **leveraging operational** synergies and creating a **new corporate** structure.

By the time **Drupa 2008** took place in mid-2008, **AVT and GMI** were ready to roll out their first **joint showcase** of **solutions.** At the world's **largest printing industry event,** held over 2 weeks once every four years, **AVT and GMI created a buzz** of excitement that demonstrated why they were **naturally designed to be joined.**

With sales, firm **leads** and interest at a **high, particularly notable** during a problematic economic period, **AVT and GMI** proved that the market was hungry for such integrated offerings. At the show, **AVT and GMI** showcased no less than 20 new solutions for the **packaging, labels, folding carton, commercial and newspaper markets.**

Designed
to be
Joined

Marketing integration has been **a natural step** for **AVT and GMI.** It both gives each partner entry into **additional market segments**, and **strengthens** the introduction of **new integrated offerings.**

During 2008, **AVT and GMI** energetically **pursued** consolidation of **sales and marketing** operations. **EMEA** (Europe, the Middle East and Africa) and **Asia-Pacific regions** were **joined** early in the year. In the fall, **sales and marketing** in the Americas (North, Central and South America) were **unified.**

Sales and marketing staff now both **broaden** their **technology perspectives and prospective client rosters.**

Closing the Gaps

The AVT-GMI integration process, **designed to create "One Company"**, is impacting every level of the company operations.

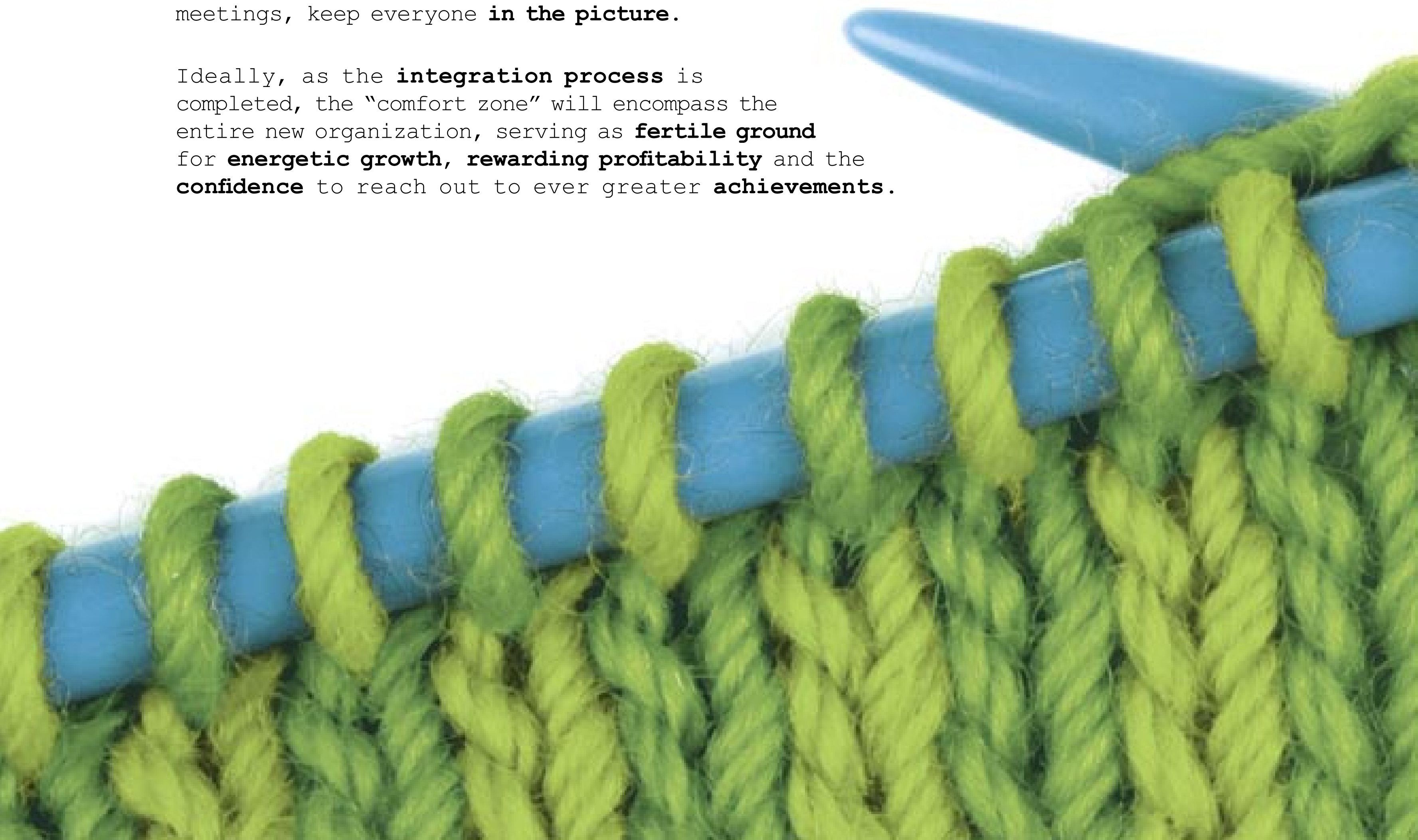
In the United States, GMI's California and Texas facilities will be consolidated under one roof in Rockwall, **Texas**. To be completed in the **spring of 2009**, the integrated facility will boost efficiency and facilitate faster **new product introductions.**

Concurrently, GMI's operation processes are being integrated with AVT's ERP system. The GMI sales **order, service and production** processes are being mapped to work with AVT's ERP system, **increasing accuracy, transparency and timeliness.**
As a result, company management, as well as sales and service organizations, will **benefit** from on-line, real-time business and customer-related information.

The **success of corporate** integration rests primarily on the people involved. Employees from different AVT and GMI departments, ranging from operations, finance, and customer support to R&D and engineering, sales and marketing, are being brought together regularly to foster **dialogue**, and create ”**comfort zones**”.

In addition, integration status updates, presented at company meetings, keep everyone **in the picture**.

Ideally, as the **integration process** is completed, the “comfort zone” will encompass the entire new organization, serving as **fertile ground** for **energetic growth**, **rewarding profitability** and the **confidence** to reach out to ever greater **achievements**.



Patterns of Comfort

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.

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

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.
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.

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

Solution	Market Served	Purpose
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 toautomatically and remotely controlink 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 systemconverts 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.

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

Our products and services are primarily sold directly to end-users, a portion of product sales are sold through distributors and strategic partners. By December 31st, 2008 approximately 2,000 PrintVision platforms, 3,100 Microcolor systems and 840 ColorQuick systems were installed worldwide. No distributor or end-user accounted for more than 10% of revenues in 2008 and 2007.

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 channels in the Americas.

On June 19th 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 which was fully impaired in the fourth quarter of 2008 (See also critical accounting policies).
AVT (Germany) GmbH was established in June 2002 to absorb the assets and operations of GVS and became our selling arm in the German speaking countries in Europe. As of January 1st 2006 AVT (Germany) GmbH commenced serving as our direct distribution and service channel for Europe, consolidating and controlling our European operations.

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 was a privately held US corporation, supplying 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.

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, out of which $4,585 thousand impaired in the fourth quarter of 2008 (See also critical accounting policies).

- $1,137 thousand were allocated to In Process Research and Development and was 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, out of which $16,367 thousand impaired in the fourth quarter of 2008 (See also critical accounting policies).

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

The results of operations related to GMI are included in our consolidated statement of income from the date of acquisition on October 1, 2007.

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; 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 2008 the European currency decreased in value relative to the US Dollar by 5.3%. In Israel, during 2008, the New Israel Shekel ("NIS") increased in value relative to the US Dollar by approximately 1.1%.

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 newspapers products as well as our Closed Loop Color Control solutions are manufactured in 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 newspapers products are manufactured mainly in 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.

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

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.

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 a staff of highly skilled customer service engineers at our headquarters in Israel as well as in Rockwall Texas that offer support to our customers and distributors. These service engineers, as well as additional service engineers located in our subsidiaries in Europe and in the Americas, 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 with 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 certain 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 subsidiaries in the US.

Approximately 42 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.

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

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 and Goodwill

- Taxes on Income

- Stock-Based Compensation

Revenues recognition. We derive revenues primarily from two sources: product revenues, which include hardware and software. Service revenues, which is comprised mainly of income from hardware and software maintenance contracts; time and material charges; consulting and training fees and sales of spare parts. 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.

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

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 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 and Goodwill. 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 the fourth quarter of 2008, we recorded goodwill and other intangible assets impairment charges related to our long-lived assets.
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 2008 we performed our annual impairment test of acquired intangible assets and goodwill as prescribed by SFAS No, 142 and 144 using a discounted cash-flow analysis to compare the fair market value of the reporting unit to its carrying value. Since the carrying amount exceeded the fair value, the second step of the impairment evaluation was undertaken to calculate impairment loss. This evaluation of GMI's fair market value, performed by independent appraiser, indicated a non-cash impairment charge of $16,367 thousand against goodwill and a non-cash impairment charge of $4,585 thousand against Technology intangible asset. The reduction in carrying value of GMI's goodwill and Technology intangible asset is attributable to decline in the Company's forecasted business outlook, which management attributes to the impact of a deteriorating global economic environment. In addition, during the fourth quarter of 2008 the company recorded non-cash impairment charge of $825 thousand against goodwill related to Geiger Vision Systems GmbH (GVS) acquired on June 2002.

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 flow, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, the useful life over which cash flow 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 additional impairments. As of December 31, 2008, the carrying value of our long-lived asset was $7,196 thousand including $2,045 thousand of non-amortized goodwill.

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.

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

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.

Impact of Inflation and Exchange risk

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.

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,		
	2008	2007	2006
Inflation (deflation)	3.8%	3.4%	(0.1%)
Revaluation	(1.1%)	(9.0%)	(8.2%)
Inflation gap	4.9%	12.4%	8.1%

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.

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

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	Precentage of Ownership Interest
Advanced Vision Technology AVT (Germany) GmbH	Germany	100%
Advanced Vision Technology Inc	USA	100%
AVT EMEA 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, 2008, 2007 and 2006 in thousands US Dollars (GMI's operating results are included in our consolidated statement of income from October 1, 2007):

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

	2008	2007	2006
	Consolidated	Consolidated	AVT
Revenues	60,320	39,884	28,469
Cost of revenues	33,976	16,868	10,839
Gross profit	26,344	23,016	17,630
Gross margin in %	43.7%	57.7%	61.9%
Operating expenses:			
Research and development, net	11,206	6,374	3,492
Selling and marketing	13,402	9,888	6,605
General and administrative	8,427	4,709	3,018
Acquired In Process R&D	-	1,137	-
Impairment of goodwill	17,192	-	-
Total operating expenses	50,227	22,108	13,115
Operating income (loss)	(23,883)	908	4,515
Financial income (expense), net	(1,239)	2,844	1,231
Profit (loss) before taxes on income	(25,122)	3,752	5,746
Taxes on income (tax benefit)	29	(1,063)	332
Net income (loss)	(25,151)	4,815	5,414

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

The following table sets forth selected consolidated statements of income data for each of the three years ended December 31, 2008, 2007 and 2006 expressed as a percentage of total revenues:

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

	2008	2007	2006
Revenues	100%	100%	100%
Products	84.3	89.7	92.8
Services	15.7	10.3	7.2
Cost of revenues	56.3	42.3	38.1
Gross profit	43.7	57.7	61.9
Operating expenses:			
Research and development, gross	20.0	17.0	13.4
Less - grants	(1.4)	(1.0)	(1.1)
Selling and marketing	22.2	24.8	23.2
General and administrative	14.0	11.8	10.6
Acquired In Process R&D	-	2.8	-
Impairment of goodwill	28.5	-	-
Total operating expenses	83.3	55.4	46.1
Operating income (loss)	(39.6)	2.3	15.8
Financial income (expense), net	(2.1)	7.1	4.4
Profit (loss) before taxes on income	(41.7)	9.4	20.2
Taxes on income (tax benefit)	0.0	(2.7)	1.2
Net income (loss)	(41.7)	12.1	19.0

The results of 2008 include non-cash impairment charge of $17,192 thousand against Goodwill and non-cash impairment charge of $4,585 thousand against Technology intangible asset, out of which $16,367 thousand non-cash expenses are related to the GMI acquisition and $825 thousand to Geiger Vision Systems (GVS) acquired in 2002. In addition, the original schedule of amortization of acquired intangibles in 2008 is comprised of amortization of Technology of $1,395 thousand, Customer Relationship and Trade Marks of $79 thousand, and amortization of Order Back- Log of $698 thousand. Technology and Trade Marks are amortized ratably over 7-10 Relationship is amortized using the accretion method over 10 years commencing from the date of closing on years and Customer

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

October 1, 2007. Half of Order Back- Log was amortized during the fourth quarter of 2007 and the remainder was amortized in the first quarter of 2008 (in addition, In Process Research and Development in the amount of $1,137 thousand was written off at the date of closing of the GMI acquisition).

The following table sets forth selected proforma consolidated statements of income data adjusted to exclude the impact of non-cash impairment of goodwill and acquired intangible asset of $21,777 thousand in 2008, amortization of acquired intangible assets of $2,172 thousand in 2008 (compared with amortization of intangible assets of $1,093 thousand and $1,137 thousand write-off of In Process R&D in 2007), stock-based compensation expenses of $939 thousand in 2008 (compared with $731 thousand in 2007 and $582 thousand in 2006), extraordinary GMI integration costs of $1,615 thousand in 2008 (compared with $28 thousand in 2007), for each of the years ended December 31 2008, 2007 and 2006 in thousands US Dollars:

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

		2008		2007	2006
	GAAP	Adjustments	Non GAAP	Non GAAP	Non GAAP
Revenues	60,320		60,320	39,884	28,469
Cost of revenues	33,976	6,129	27,847	16,411	10,788
Gross profit	26,344	6,129	32,473	23,473	17,681
Gross margin in %	43.7%		53.80%	58.9%	62.1%
Operating expenses:					
Research and development, net	11,206	465	10,741	6,251	3,439
Selling and marketing	13,402	1,166	12,236	8,970	6,503
General and administrative	8,427	1,551	6,876	4,355	2,642
Acquired in process R&D	-	-	-	-	-
Impairment of goodwill	17,192	17,192	-	-	-
Total operating expenses	50,227	20,374	29,853	19,576	12,584
Operating income	(23,883)	26,503	2,620	3,897	5,097
Financial income, net	(1,239)		(1,239)	2,844	1,231
Integration costs	-	1615	1615	28	-
Profit before taxes on income	(25,122)	24,888	(234)	6,713	6,328
Taxes on income (tax benefit)	29		29	(1,063)	332
Net income (loss)	(25,151)	24,888	(263)	7,776	5,996

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

Year ended December 31, 2008, compared with year ended December 31, 2007

The year ended December 31, 2008 was a year of immense contradictions. In the first half of the year we achieved record revenues numbers in our businesses while in the second half of 2008 we increasingly felt the effects of the global economic recession.

2008 was also a challenging year of integration of AVT and GMI Sales and Marketing and Customer Support organizations world-wide; of consolidation of GMI operations and R&D activities in California and Texas under one roof in Rockwall Texas, as well as of consolidation of the finance activities in our headquarters in Israel. While we expect 2009 to present industry-wide challenges, we believe that the implementation of the restructuring measures enacted in the second half of 2008 will increasingly contribute to streamline our operations, will help facilitate faster realization of cross market opportunities and form stronger and effective unified organization, providing better solutions and services to our customers globally.

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 2008 totaled $60.3 million 51.2% higher than the $39.9 million generated in 2007. The increase in total revenues is due to full year inclusion of GMI in 2008.

Revenues in the fourth quarter of 2008 were $11.7 million representing a decrease of 20.2% of the revenues in Q3 2008 and 26.0% less than in Q4 2007.

AVT product line revenues in 2008 were $30.3 million representing a decrease of 6.3% compared with revenues of $32.4 million in 2007. The decrease in AVT product line revenues is the result of the weak market conditions in the second half of 2008.

GMI product line revenues in 2008 were $30.0 million (GMI was acquired October 1, 2007).

GMI product line revenues in the fourth quarter of 2008 were $6.6 million a decrease of 2.3% of the revenues in Q3 2008 and 12.1% less than in Q4 2007, representing the weak market conditions in the second half of 2008.

Revenues from services are generated from maintenance contracts; time and material charges; consulting and training fees and sales of spare parts. We recognize revenues over the contractual period or as services are performed. Service revenues in 2008 totaled $9.5 million (out of the total revenues of $60.3 million) 130.3% higher than the $4.1 million generated in 2007. The increase in service revenues is attributable to the significant contribution of GMI's product line and the continued increase in the number of service contracts signed during the year. Service orders received during 2008 were $9.3 million, 101.6% higher than in 2007. The service orders, not yet recognized as revenues, will be recognized ratably over the contractual period.

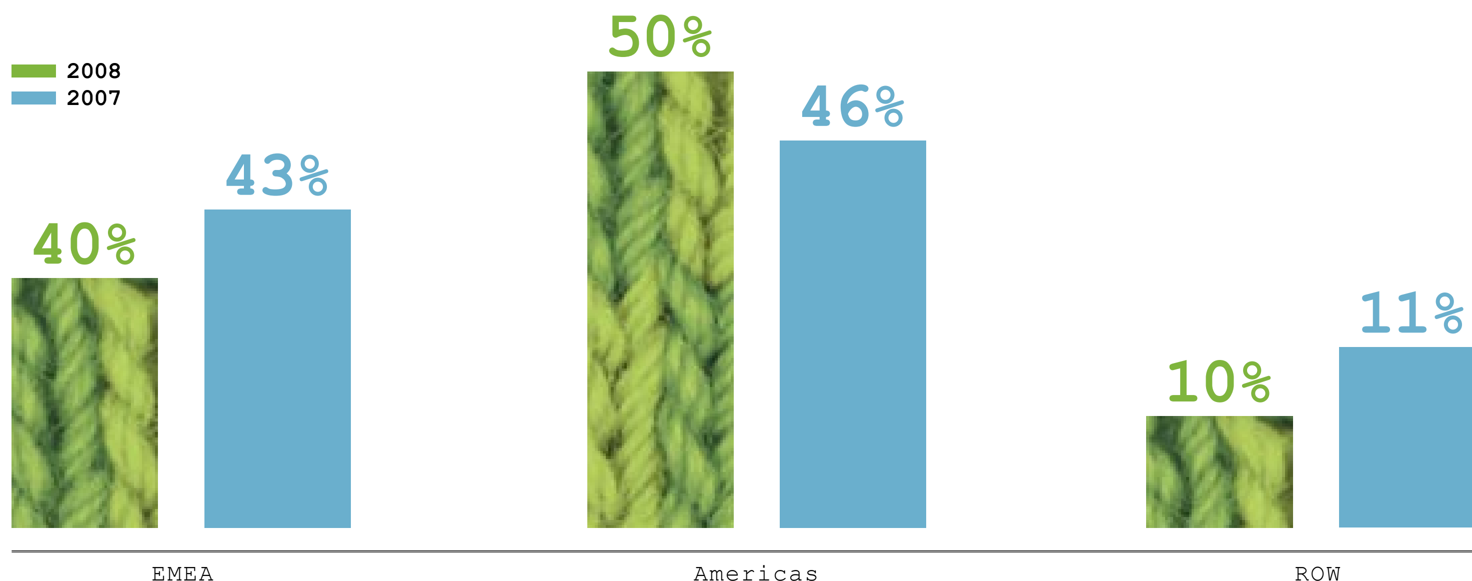
During 2008 order booking totaled $50.6 million representing an increase of 24.9% over 2007 order booking of $40.5 million attributable to full year inclusion of GMI in 2008. The ratio of order booking to revenues in 2008 was 83.8% attributable mostly to the global economic slowdown and the weak market conditions.

As of December 31, 2008 order backlog totaled $14.0 million, a decrease of 39.3% compared with the balance at December 31, 2007 providing us with visibility of approximately one quarter of revenues.

We estimate that out of this back-log, 55%-70% will become revenue during Q1 of 2009, while the remainder will become revenue in the proceeding three quarters.

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

The following chart sets forth breakdown of revenues by territory for each of the two years ended December 31, 2008 and 2007:



In 2008 the American market contributed 50% of total revenues compared with 46% in 2007 while EMEA (Europe, Middle East & Africa) contributed only 40% of total revenue compared with 43% in 2007. The increase in America's contribution is attributable to the relative strength of GMI product line in this region. Revenues generated in the Rest of the World contributed 10% of total revenues compared with 11% in 2007.

Cost of Revenues / Gross Profit

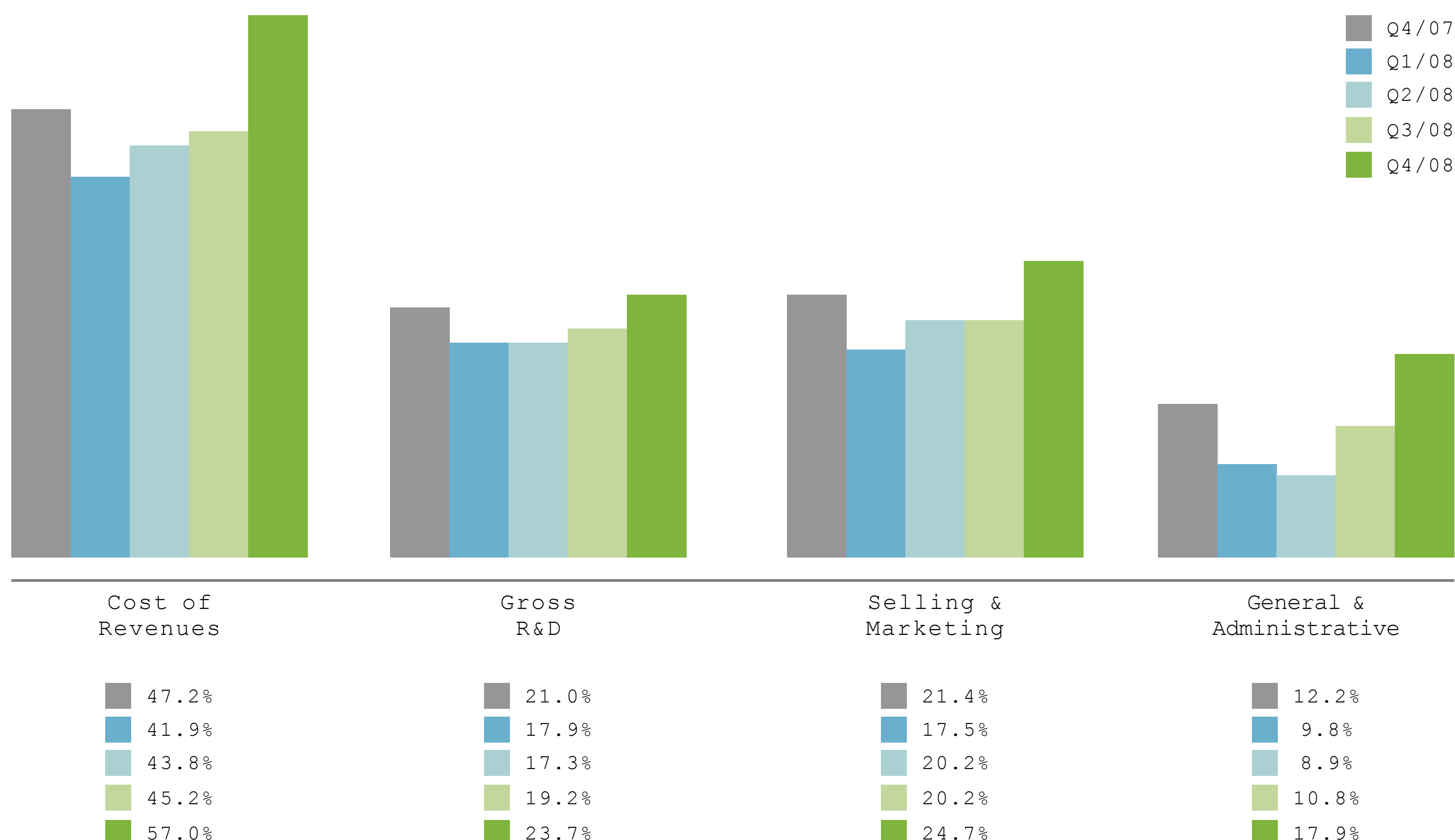
Cost of revenues includes materials, labor, and an estimate of costs associated with installation, warranty and training. We generally provide a one-year warranty to the end- user. A provision, based on our experience and engineering estimates, is recorded to cover probable costs in connection with such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

Gross margin in 2008 was 43.7% compared with 57.7%, in 2007. Proforma gross margin in 2008 (excluding the impact of non-cash impairment charge, amortization of acquired intangible assets, stock based compensation expense and extraordinary GMI integration costs) was 53.8% compared with proforma gross margin of 58.9% in 2007. The decrease is due primarily to the inherent lower gross margin of GMI's product line which increased its proportionate share in total revenues due to full year inclusion of GMI results in 2008, compared with a consolidation of GMI's results only in the fourth quarter of 2007 coupled with higher proportion of service revenues in 2008 which carry lower margins relative to products, the unfavorable impact of the Euro and NIS exchange rates relative to the US Dollar and the impact of global economic slowdown.

Gross Margin may fluctuate due to changes in product mix as the sale of software options is generally increasing the platform's selling price while keeping the same bill of material cost, and thus improving the gross profit.

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

The following table sets forth selected proforma consolidated expenditures data (excluding non-cash impairment charges, amortization of acquired intangible assets, stock-based compensation expense and extraordinary GMI integration costs) for each of the five quarters ended 31.12.2008, 30.9.2008, 30.6.2008, 31.3.2008 and 31.12.2007 expressed as a percentage of total revenues.



	Cost of Revenues	Gross R&D	Selling & Marketing	General & Administrative
Q4/07	47.2%	21.0%	21.4%	12.2%
Q1/08	41.9%	17.9%	17.5%	9.8%
Q2/08	43.8%	17.3%	20.2%	8.9%
Q3/08	45.2%	19.2%	20.2%	10.8%
Q4/08	57.0%	23.7%	24.7%	17.9%

Research and Development Costs

Research and development costs are charged to the statement of operations as incurred. Government funding for the development of approved projects is recognized as a reduction of expenses as the related costs are incurred.

In 2008, net research and development expenses increased to $11,206 thousand, 75.8% higher than in 2007 ($6,374 thousand). The increase is due primarily to the inclusion of GMI for all of 2008 compared to only Q4 2007 in 2007.

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

The gross costs of research and development are partially offset by government grants. In 2008 total government grants and participation recorded were $842 thousand compared with $403 thousand recorded in 2007.
Proforma net research and development expenses in 2008 (excluding extraordinary GMI integration costs and stock- based compensation expense) increased by 71.8% to $10,741 thousand compared to $6,251 thousand 2007.

Selling and Marketing Expenses
In 2008, selling and marketing expenses increased to $13,402 thousand, 35.5 % higher than in 2007 ($9,888 thousand). The increase is due primarily to the inclusion of GMI for all of 2008 compared to only Q4 2007 in 2007.
Proforma selling and marketing expenses in 2008 (excluding amortization of acquired intangible assets, stock-based compensation expense and extraordinary GMI integration costs) increased by 36.4% to $12,236 thousand compared to $8,970 thousand in 2007.

General and Administrative Expenses
In 2008, general and administrative expenses increased to $8,427 thousand, 78.9% higher than 2007 ($4,709 thousand). The increase is due primarily to the inclusion of GMI for all of 2008 compared to only Q4 2007 in 2007.
Proforma expenses in 2008 (excluding stock- based compensation expense and extraordinary integration costs) increased by 57.9% to $6,876 thousand compared to $4,355 thousand in 2007.

Stock-Based Compensation
Based on SFAS 123R we recorded commencing January 1, 2006, share-based payments as expenses based on their fair value at the grant date. 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 2008 was $939 thousand compared with $731 thousand in 2007.

Operating and Net Income
Net loss for the full year ended December 31, 2008 was $25,151 thousand or loss of $4.75 per share (diluted) compared with net income of $4,815 thousand or profit of $0.90 per share (diluted) in 2007.
Consolidated proforma net income for 2008 (excluding non-cash impairment charges, amortization of acquired intangible assets, stock-based compensation expense and extraordinary GMI integration costs), was $1,351 thousand compared with proforma net income of $7,804 thousand in 2007.

The total amount of items excluded in proforma financial results presentation comprising of impairment charges, amortization of intangibles, stock-based compensation expense and extraordinary GMI integration expenses totaled $26,503 thousand in 2008 compared with a total of $2,989 thousand recorded as applicable for same expense items in 2007.

Consolidated proforma operating income (excluding all expense items cited above) declined by 32.8% from a profit of $3,897 thousand in 2007 to a profit of $2,620 thousand in 2008.
Consolidated Proforma operating income was 4.3% of revenues in 2008 compared with 9.8% in 2007. The decrease in proforma EBIT in 2008 is due primarily to lower gross margin.

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

Proforma EBITDA in 2008 (excluding stock-based compensation expense and extraordinary GMI integration costs) declined by 20.5% from a profit of $4,354 thousand in 2007 to a profit of $3,460 thousand in 2008.

Financial Income (expense), net
Net financial expenses for 2008 were $1,239 thousand compared with net income of $2,844 thousand for 2007.

Financial income is comprised of interest incurred on time deposits and bonds less interest expenses on lines of credit and exchange rate differences. The decrease in financial income from previous year is attributable to lower average cash balance coupled with lower interest rates and to the devaluation of the Euro to the US Dollar. Financial income in 2008 accounted for $282 thousand compared with $1,619 thousand in 2007.
An additional net expense of $1,521 thousand was generated from exchange rate differences plus interest and bank charges.

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.
At the end of 2008, amid the overall economic downturn and uncertain outlook, management concluded that it is not likely that certain deferred tax assets previously recorded will be realized, resulting in a valuation allowance of $629 thousand recorded against a portion of our net deferred tax assets.

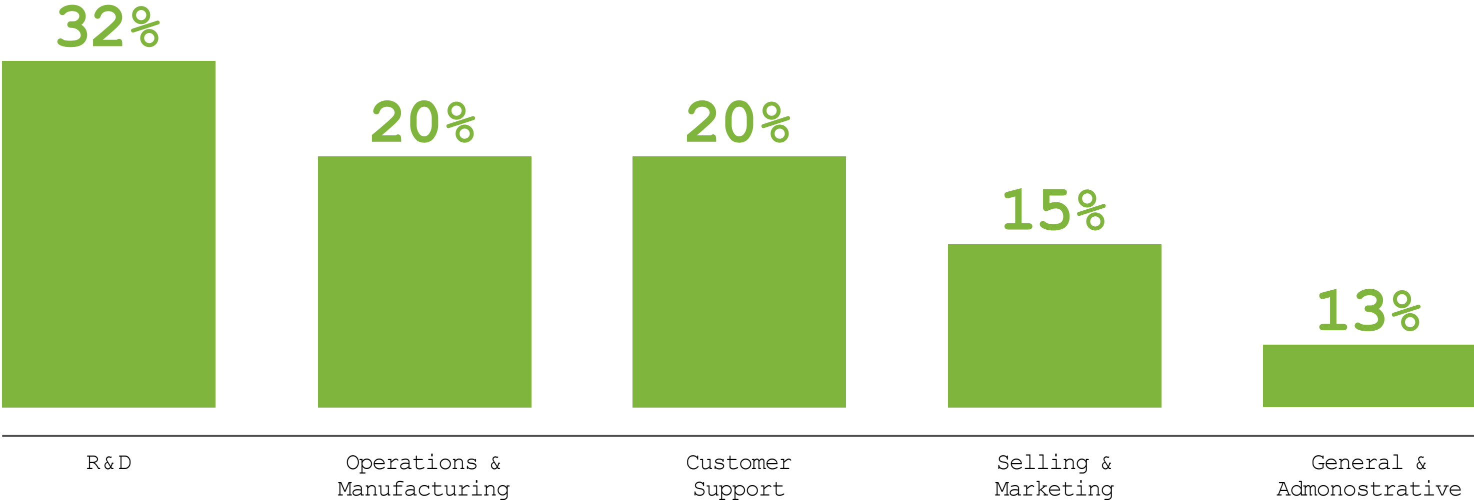
Liquidity and Capital Resources
As of December 31, 2008 our total current assets were $33.3 million, including a total cash and financial investment balance of $13.1 million compared with cash and financial investment balance of $16.7 million on December 31, 2007.

During 2008, $2,906 thousand were used in operating activities compared with $8,233 thousand provided by operating activities in 2007. Net cash provided by financing activities 2008 totaled $215 thousand.
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 the year ended December 31, 2008 were 53 days compared with 55 days for the year ended December 31, 2007.
Our 2008 net capital expenditures on fixed assets were $857 thousand compared with $455 thousand used during 2007.

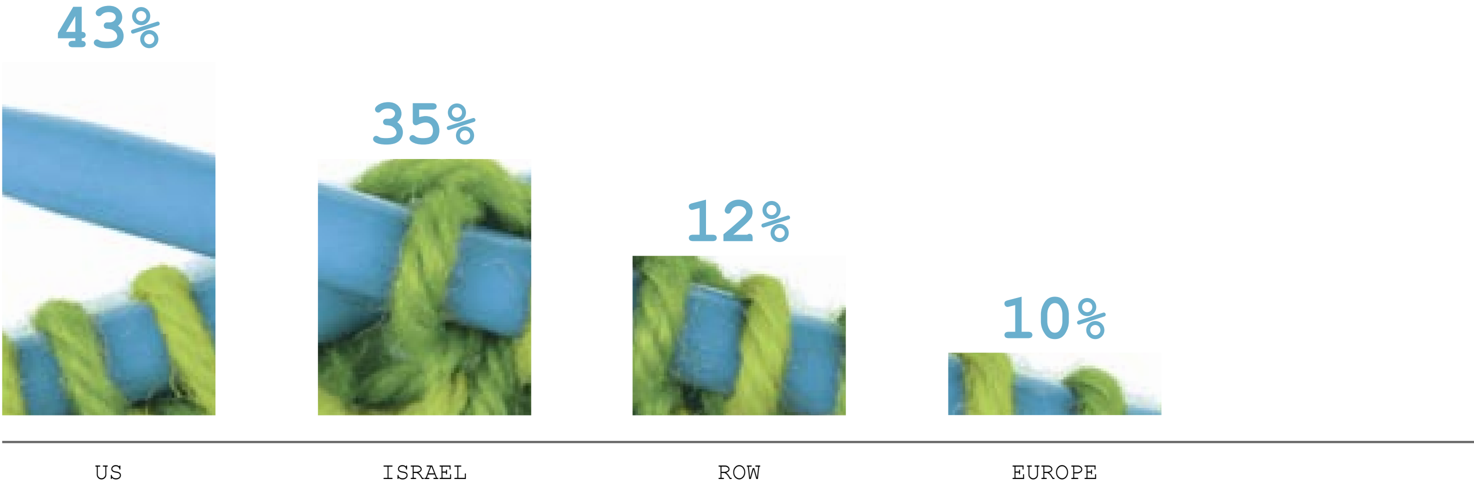
Employees
Our employees consistently remain our major asset, committed to the drive for technological leadership and outstanding customer service. Our dedicated team has repeatedly demonstrated that it shares our vision, and has the motivation, innovation and commitment to customer satisfaction that are the key ingredients of healthy growth.
On December 31, 2008, 280 people were employed by us worldwide compared with 309 people we employed at December 31 2007.

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

The breakdown of employees by activity is as follows:



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



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Report of Independent Auditors

To the board of directors and 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, 2008 and 2007, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 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, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

Kost Forer Gabbay and Kasierer

Tel-Aviv, Israel
April 30, 2009

KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Consolidated Balance Sheets

U.S. dollars in thousands
December 31,

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$13,105	$16,653
Trade receivables (net of allowance for doubtful accounts		
of $695 and $185 as at December 31, 2008 and 2007, respectively)	8,688	9,499
Inventories	7,133	6,168
Other accounts receivable and prepaid expenses	3,242	3,415
Deferred income taxes	1,191	2,191
Total current assets	33,359	37,926
LONG-TERM ASSETS:		
Deferred income taxes	469	697
Severance pay fund	1,901	1,835
Total long-term assets	2,370	2,532
PROPERTY AND EQUIPMENT, NET	2,090	2,096
OTHER ASSETS:		
Intangible assets, net	5,151	11,908
Goodwil	2,045	19,237
Total other assets	7,196	31,145
Total assets	$45,015	$73,699

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,	
	2008	2007
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$1,658	$1,942
Employees and payroll accruals	3,178	3,992
Customer advances and deferred revenues	5,943	6,971
Accrued expenses and other liabilities	4,781	6,296
Total current liabilities	15,560	19,201
LONG-TERM LIABILITIES:		
Deferred income taxes	-	1,228
Accrued severance pay	3,124	2,942
Total long-term liabilities	3,124	4,170
SHAREHOLDERS' EQUITY:		
Share capital:		
Ordinary shares of New Israeli Shekels (NIS) 2 par value:		
30,000,000 shares authorized at December 31, 2008 and 2007;		
6,296,898 shares issued at December 31, 2008 and 2007; 5,306,795		
and 5,255,470 shares outstanding at December 31, 2008 and 2007, respectively	3,402	3,402
Additional paid-in capital	61,385	60,446
Treasury shares at cost - 990,103 and 1,041,428 shares as of		
December 31, 2008 and 2007, respectively	(8,343)	(8,776)
Accumulated deficit	(30,113)	(4,744)
Total shareholders' equity	26,331	50,328
Total liabilities and shareholders' equity	$45,015	$73,699

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

Consolidated Statements of Operations

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

	2008	2007	2006
Revenues:			
Products	$50,861	$35,776	$26,424
Services	9,459	4,108	2,045
Total Revenues	60,320	39,884	28,469
Cost of revenues:			
Products	23,244	10,616	6,824
Services	10,732	6,252	4,015
Total Cost of revenues	33,976	16,868	10,839
Gross profit	26,344	23,016	17,630
Operating expenses:			
Research and development	12,048	6,777	3,808
Less - grants	(842)	(403)	(316)
Selling and marketing	13,402	9,888	6,605
General and administrative	8,427	4,709	3,018
Acquired in-process research and development	-	1,137	-
Impairment of goodwill	17,192	-	-
Total operating expenses	50,227	22,108	13,115
Operating income (loss)	(23,883)	908	4,515
Financial income (expense), net	(1,239)	2,844	1,231
Income (loss) before taxes on income	(25,122)	3,752	5,746
Taxes on income (tax benefit)	29	(1,063)	332
Net income (loss)	$(25,151)	$4,815	$5,414
Basic earnings (loss) per ordinary share	$(4.75)	$0.9	$1.20
Diluted earnings (loss) per ordinary share	$(4.75)	$0.90	$1.13

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

Consolidated Statements of Changes in Shareholders' Equity

U.S. dollars in thousands

	Share capital	Additional paid-in capital	Treasury shares	Accumulated other comprehensive income	Accumulated deficit	Total comprehensive income	Total comprehensive income
Balance as of January 1, 2006	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)
Opening balance at 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
Issuance of treasury shares upon exercise of options	–	–	433	–	(218)		215
Stock-based compensation related to options granted to employees	–	939	–	–	–		939
Loss	–	–	–	–	(25,151)	$(25,151)	$(25,151)
						$(25,151)	
Balance as of December 31, 2008	$3,402	$61,385	$(8,343)	–	$(30,113)		$26,331

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,

	2008	2007	2006
Cash flows from operating activities:			
Net income (loss)	(25,151)	4,815	5,414
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Stock-based compensation related to options granted to employees	939	731	582
Realized loss on marketable securities, net	-	135	-
Depreciation of property and equipment	840	457	237
Amortization of intangible assets	2,172	1,093	-
Capital loss	23	-	-
Acquired in-process research and development	-	1,137	-
Impairment of technology	4,585	-	-
Impairment of goodwill	17,192	-	-
Amortization of marketable debt securities premium and accretion of discount	-	(7)	4
Decrease (increase) in trade receivables, net	811	364	(377)
Increase in inventories	(965)	(618)	(219)
Decrease (increase) in other accounts receivable and prepaid expenses	173	(893)	(380)
Increase in deferred income taxes, net	-	(1,761)	-
Decrease in trade payables	(284)	(898)	(108)
Increase (decrease) in employees and payroll accruals	(814)	1,255	214
Increase (decrease) in customer advances and deferred revenues	(1,028)	(414)	789
Increase (decrease) in accrued expenses and other liabilities	(1,515)	2,553	(81)
Increase in accrued severance pay, net	116	284	134
Net cash provided by (used in) operating activities	(2,906)	8,233	6,209
Cash flows from investing activities:			
Proceeds from redemption of marketable securities	-	8,500	10,235
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)
Purchase of property and equipment	(857)	(455)	(407)
Acquisition of GMI, net of cash acquired	-	(32,875)	-
Net cash provided by (used in) investing activities	(857)	(23,972)	7,835
Cash flows from financing activities:			
Proceeds from sale of treasury shares	-	9,595	-
Proceeds from exercise of options granted to employees	215	570	482
Net cash provided by financing activities	215	10,165	482
Increase (decrease) in cash and cash equivalents	(3,548)	(5,574)	14,526
Cash and cash equivalents at the beginning of the year	16,653	22,227	7,701
Cash and cash equivalents at the end of the year	13,105	16,653	22,227
Supplemental disclosure of cash flow information:			
Cash paid during the year for income taxes	582	460	-

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,

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 was accounted for using the purchase method of accounting in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141 "Business Combinations". The purchase price was 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 was recorded as goodwill.

The Company has allocated the total purchase price as follows:

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

(1) During 2008 those assets were determined to be impaired (see Note 2h and Note 2i).

Notes to Consolidated Financial Statements

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

Current assets and liabilities were recorded at their carrying amounts which is reasonably approximates for 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 year 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

Notes to Consolidated Financial Statements

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

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S.("U.S. GAAP").

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

b. Financial statements in U.S. dollars:
A majority of the revenues of the Company and certain of its subsidiaries are generated in U.S. dollars ("dollars"). In addition, a substantial portion of the Company's and certain of its subsidiaries' costs is incurred in dollars. Since management believes that the dollar is the currency of the primary economic environment in which the Company and its subsidiaries operate, the dollar is its functional and reporting currency. Accordingly, amounts in currencies other than U.S dollars have been remeasured in accordance with SFAS No.52, "Foreign Currency Translation" as follows:

Monetary balances - at the exchange rate in effect on the balance sheet date.

Expenses - at the exchange rates in effect as of the date of recognition of the transaction.

All exchange gains and losses from the remeasurement mentioned above are reflected in the statement of operations in financial income, net.

Management considers the non-U.S. subsidiaries to be a direct, integral extension of the parent company's operations. Accordingly, the functional currency of these subsidiaries is the dollar.

c. Principles of consolidation:
The consolidated financial statements include the accounts of the Company and its subsidiaries ("the Group"). Intercompany balances and transactions including profits from intercompany sales not yet realized outside the Group, 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. 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. The write-offs that were recorded during the years were insignificant.

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.

f. 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

g. Intangible assets:
The intangible assets are stated at cost, net of accumulated amortization. The intangible assets are amortized over their estimated useful life using the straight-line method or the accelerated method. 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.

Notes to Consolidated Financial Statements

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

h. Impairment of long-lived assets and intangible assets subject to amortization:

The Company's and its subsidiaries' long-lived assets and intangible assets subject to amortization are reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. During 2006 and 2007, no impairment losses have been identified.

The Company performed an impairment test for as of December 31, 2008 since indicators of impairment were present. The test resulted in an impairment of the technology related to the acquisition of GMI (see Note 1b) in the amount of $4,585.

In performing the above analyses and tests, the Company’s management provided forecasts and related assumptions to the third party valuation firm, which applied its valuation techniques and required economic models. These assumptions and results may differ from actual results due to, among other things, technological change, economic conditions, changes to its business models or changes in operating performance and an impairment charge may be required in the future. Fair value is determined using the discounted future cash flows method. Significant estimates used in the methodology include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reporting units.

i. 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.

For the year ended December 31, 2008, the Company engaged an independent valuation firm to perform its annual goodwill impairment test. The fair value of a reporting unit is determined using the discounted future cash flows method. Significant estimates used in the methodology include estimates of future cash flows, 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 units based on the guidance of SFAS 142. The Company performed its annual impairment test as of December 31, 2008. Since the carrying value of each of the reporting units exceeded their fair value, and based on the second phase of the impairment test, the Company recorded an impairment of

goodwill related to the acquisition of GMI (see Note 1b) in the amount of $16,367. In addition, the Company recorded an impairment of goodwill related to the other reporting unit which was derived from the acquisition made in June 2002 of Geiger Vision Systems GmbH (GVS) in the amount of $825.

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 follows 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.

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:

Notes to Consolidated Financial Statements

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

	2008	2007
Balance, beginning of year	$889	$559
Warranties assumed as part of business combination	-	210
Warranties utilized and expired during the year	(637)	(672)
Warranties issued during the year	394	792
Balance, end of year	$646	$889

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.
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, 2008 and 2007, the allowance for doubtful accounts amounted to $695 and $185, respectively. Bad debt expense amounted to $510, $56 and $76 in 2008, 2007 and 2006, respectively. To date, the Company has not experienced any material losses on its account receivables. The risk of collection associated with account receivables is mitigated by the diversity and number of customers.

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. The Company has applied the provisions of SAB 107 in its adoption of SFAS No. 123R.

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 Monte Carlo simulation model for options granted with the following weighted-average assumptions:

	Year ended December 31,		
	2008	2007	2006
Risk-free interest rate	2.70%	4.96%	3.78%
Suboptimal exercise multiple	3	3	3
Forfeiture rate	7.30%	8.44%	8.67%
Dividend yield	-	-	-
Expected volatility	47%	39%	54%

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 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.

Research and development grants recognized amounted to $842, $403and $316 in 2008, 2007 and 2006, respectively. Total royalties accrued or paid amounted to $1,041, $1,126 and $996 in 2008, 2007 and 2006, respectively and were recorded in the cost of revenues.

r. Fair value of financial instruments:
The following methods and assumptions were used by the Company and its subsidiaries in estimating their fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, trade receivables, other accounts receivable, trade payables and other accounts payable approximate their fair values due to the short-term maturities of such instruments.

Effective January 1, 2008, the Company adopted the provision of SFAS 157, "Fair Value Measurements", except as it applies to the nonfinancial assets and nonfinancial liabilities subject to FSP 157-2. SFAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, SFAS 157 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 - Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

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 or losses 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, 2008, 2007 and 2006 amounted to $641, $660 and $398, respectively.

t. Basic and diluted net earnings per share:
Basic net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (loss) per share is computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year, in accordance with Statement of Financial Accounting Standard No. 128, "Earnings Per Share" ("SFAS 128").

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 noncurrent 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.

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 as tax expenses.

v. Impact of recently issued accounting pronouncements:
In December 2007, the FASB issued SFAS 141(R), ‘‘Business Combinations’’ (‘‘SFAS 141(R)’’). This Statement replaces SFAS No. 141, ‘‘Business Combinations’’, and requires an acquirer to recognize the assets acquired, the liabilities assumed, including those arising from contractual contingencies, any contingent consideration and any noncontrolling interest in the acquire at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the statement.

SFAS 141(R) also requires the acquirer in a business combination achieved in stages (sometimes referred to as a step acquisition) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquire, at the full amounts of their fair values (or other amounts determined in accordance with SFAS 141(R)). In addition, SFAS 141(R)'s requirement to measure the noncontrolling interest in the acquire at fair value will result in recognizing the goodwill attributable to the noncontrolling interest in addition to that attributable to the acquirer.
SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS 141(R) is not expected to have a material effect on accounting for our current subsidiaries.

In December 2007, the FASB issued SFAS 160, ''Noncontrolling Interests in Consolidated Financial Statements'' (''SFAS 160''). SFAS 160 amends ARB 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. 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 fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of SFAS 160 is not expected to have a material effect on accounting for current subsidiaries.

In February 2008, the FASB issued FASB Staff Position ("FSP") FAS No. 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2"), to delay the effective date of FASB Statement 157 for one year for certain nonfinancial assets and nonfinancial liabilities, excluding those that are recognized or disclosed in financial statements at fair value on a recurring basis (that is, at least annually). For purposes of applying the FSP 157-2, nonfinancial assets and nonfinancial liabilities include all assets and liabilities other than those meeting the definition of a financial asset or a financial liability in FASB Statement 159. FSP 157-2 defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP 157-2. The Company does not expect the adoption of FSP 157-2 to have a material impact on its financial position, results of operations or cash flows.

In April 2008, the FASB issued FSP 142-3, "Determination of the Useful Life of Intangible Assets" (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets". FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of FSP 142-3 will have a material impact on the Company's consolidated financial position, results of operations and cash flows.

Notes to Consolidated Financial Statements

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

EITF Issue No. 08-7, “Defensive Intangible Assets” ("EITF 08-7"), requires an acquiring entity to account defensive intangible assets as a separate unit of accounting. Defensive intangible assets should not be included as part of the cost of the acquirer’s existing intangible assets because the defensive intangible assets are separately identifiable. Defensive intangible assets must be recognized at fair value in accordance with SFAS 141(R) and SFAS 157. EITF 08-7 will be effective for the reporting period beginning after December 15, 2008. The Company does not expect a material impact on its consolidated financial statements from adoption of EITF 08-7.

[3] Other Accounts Receivable and Prepaid Expenses

	Year ended December 31,	
	2008	**2007**
Government grants	580	156
Government authorities	1,635	911
Accrued interest	-	29
Prepaid expenses	955	1,858
Other accounts receivable	72	461
	3,242	3,415

[4] Inventories

	Year ended December 31,	
	2008	**2007**
Raw materials	4,140	2,418
Work in progress	1,345	1,376
Finished products	1,648	2,374
	7,133	6,168

Notes to Consolidated Financial Statements

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

[5] Property And Equipment

	Year ended December 31,	
	2008	2007
Cost:		
Computers and peripheral equipment	2,441	2,123
Machinery and equipment	1,348	1,299
Office furniture and equipment	515	228
Leasehold improvements	374	234
	4,678	3,884
Accumulated depreciation:		
Computers and peripheral equipment	1,758	1,241
Machinery and equipment	575	331
Office furniture and equipment	130	101
Leasehold improvements	125	115
	2,588	1,788
Property and equipment, net	2,090	2,096

Depreciation expense for the years ended December 31, 2008, 2007 and 2006 was $840, $457, and $237, respectively.

During 2008, the Company recorded a reduction of approximately $45 and $22 to the cost and accumulated depreciation, respectively, of equipment no longer in use, following an assessment made by the Company.

During 2007, the Company recorded a reduction of approximately $325 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 8c.

[6] Goodwill and Intangible Assets, Net

a. Goodwill

	December 31,	
	2008	2007
Goodwill, beginning of year	19,237	825
Acquisition of GMI	-	18,412
Impairment	(17,192)	-
Goodwill, end of year	2,045	19,237

Notes to Consolidated Financial Statements

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

b. Intangible assets, net

	December 31,	
	2008	**2007**
Cost:		
Technology (1)	5,387	9,972
Customer Relationships	1,405	1,405
Backlog	1,396	1,396
Trademarks	434	434
	8,622	13,207
Accumulated amortization:		
Technology	1,950	555
Customer Relationships	71	35
Backlog	1,396	698
Trademarks/Tradenames	54	11
	3,471	1,299
Intangible assets,net	5,151	11,908

(1) Net of an impairment of $4,585 (see Note 2i).

Amortization expenses amounted to $2,172, $1,093 and $0 for the years ended December 31, 2008, 2007 and 2006, respectively.

Estimated amortization expenses for the years ended:

Year	**December 31,**
2009	919
2010	902
2011	888
2012	830
2013	773
Thereafter	839
	5,151

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

[7] Accrued Expenses and Other Liabilities

	December 31, 2008	2007
Provision for warranty costs	646	889
Government authorities and tax provision	2,384	2,746
Accrued expenses and other liabilities	1,751	2,661
	4,781	6,296

[8] Commitments and Contingent Liabilities

a. Lease commitments:
The Company and its subsidiaries lease office facilities and motor vehicles, under operating leases, for periods ending in 2016.

The Company has renewal option for its lease office facilities until 2013.
Future minimum lease commitments under non-cancelable operating leases as of December 31, 2008, are as follows:

Year	Lease Commitment
2009	2,096
2010	1,370
2011	1,322
2012	1,293
2013 and thereafter	2,026
	8,107

Total rent expenses for the years ended December 31, 2008, 2007 and 2006 amounted to $2,294, $1,443 and $1,063, 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 including interest at the applicable LIBOR rate at the time the grants were received.

As of December 31, 2008, the Company has a contingent obligation to pay royalties in respect of the aforementioned grants in the approximate amount of $2,008.

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. As of December 31, 2008, no such credit was provided.

[9] Income Taxes

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

b. Israel taxation
1. Corporate tax structure:
Taxable income of Israeli companies is subject to tax at the rate of 31% in 2006, 29% in 2007, 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter.
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" or a "Privileged Enterprise", under the Law, in four 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 (for "Approved Enterprise" only upon distribution).

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.

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

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.

The entitlement to the above benefits is conditional upon Company's fulfilling the conditions stipulated by the Law, regulations published hereunder 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, 2008, $14,394 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 $3,599 would be incurred as of December 31, 2008. 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, 2008, the Company had approximately $950 of Israeli carryforwards tax losses, which may be carried forward and offset against taxable income in the future for an indefinite period.

As of December 31, 2008, the U.S. subsidiary had U.S. federal carryforward tax losses of approximately $4,200 that can be carried forward and offset against taxable income for 15-20 years and expire from 2011-2028.
As of December 31, 2008, the German subsidiary had carryforward tax losses of approximately $2,200, 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.

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

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, 2008, 2007 and 2006, the Company's deferred taxes were in respect of the following:

	December 31,		
	2008	2007	2006
Deferred tax assets:			
Operating loss carryforwards	2,463	1,984	3,466
Intangible assets	1,565	-	-
Reserves and allowances not currently deductible	3,023	2,465	186
Total deferred tax asset	7,051	4,449	3,652
Deferred tax liability:			
Intangible assets	-	(1,141)	-
Property and equipment	(141)	(87)	-
Total deferred tax liability	(141)	(1,228)	-
Net deferred tax asset before valuation allowance	6,910	3,221	3,652
Valuation allowance	(5,250)	(1,561)	(3,315)
Net deferred tax asset	1,660	1,660	337
Domestic:			
Current deferred tax asset	1,303	555	-
Non-current deferred tax asset	479	477	337
Valuation allowance	(122)	-	-
	1,660	1,032	337
Foreign:			
Current deferred tax asset	1,447	1,636	-
Non-current deferred tax asset	3,822	1,781	-
Non- current deferred tax liability	(141)	(1,228)	-
Valuation allowance	(5,128)	(1,561)	-
	-	628	-
	1,660	1,660	337

Notes to Consolidated Financial Statements

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

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

	Year ended December 31,		
	2008	2007	2006
Domestic	(2,617)	9,053	7,803
Foreign	(22,505)	(5,301)	(2,057)
	(25,122)	3,752	5,746

g. Taxes on income (tax benefit) are comprised as follows:

	Year ended December 31,		
	2008	2007	2006
Current	29	689	332
Deferred	-	(1,752)	-
	29	(1,063)	332
Domestic	(342)	(306)	270
Foreign	371	(757)	62
	29	(1,063)	332
Domestic:			
Current	286	389	270
Deferred	(628)	(695)	-
	(342)	(306)	270
Foreign:			
Current	(257)	(129)	62
Deferred	628	(628)	-
	371	(757)	62

Notes to Consolidated Financial Statements

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

h. Reconciliation of the theoretical tax expense:

	Year ended December 31,		
	2008	2007	2006
Income (loss) before taxes on income	(25,122)	3,752	5,746
Statutory tax rate	27%	29%	31%
Theoretical tax at statutory tax rate	(6,783)	1,088	1,781
Increase (decrease) in respect of:			
Losses, reserves and allowances for which valuation allowance was provided	686	824	719
Utilization of carryforward losses for which valuation allowance was provided in prior years	(159)	(303)	(1,290)
Tax adjustment in respect of "Approved Enterprise" status	(371)	(3,268)	(1,318)
Tax adjustment in respect of foreign subsidiaries different tax rates	(2,768)	197	-
Stock-based compensation expense	265	213	180
Non-deductible expenses	618	186	260
Impairment of Goodwill and Intangible assets	8,171	-	-
Other	370	-	-
Actual tax expense (benefit)	29	(1,063)	332

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 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. The Company recognizes $286 as interest accrued and rate differences related to unrecognized tax benefits as tax expenses.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

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

Balance as of January 1, 2008	2,169
Additions for tax positions of prior years	285
Reductions for tax positions of prior years	(559)
Balance as of December 31, 2008	1,895

The Company and its subsidiaries are routinely examined by various taxing authorities. The Company's tax years 2005 through 2008 remain subject to examination by the Israeli Tax Authorities.
The U.S. subsidiaries tax years 2004 through 2008 remain subject to examination by the IRS for U.S. federal tax purposes. There are tax years which remain subject to examination in various other jurisdictions that are not material to the Company's financial statements.

[10] 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 2008 and 2007, 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, 2008 and 2007, 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 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, 2008, 327,084 options are available for future grants.

Notes to Consolidated Financial Statements

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

A summary of the stock option activities in 2008 is as follows:

	Amount	Weighted average exercise price	Weighted average remaining contractual life	Aggregate Intrinsic value
Outstanding at January 1, 2006	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		
Granted	238,275	6.30		
Exercised	(51,325)	4.21		
Forfeited	(299,400)	14.14		
Outstanding at December 31, 2008	446,955	5.10	6.46	*)307
Vested and expected to vest at December 31, 2008	385,165	5.16	3.61	**)258
Exercisable at December 31, 2008	202,930	5.64	5.01	***)87

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

*) Represents intrinsic value of 161,446 outstanding options that are in-the-money as of December 31, 2008. The remaining 285,509 outstanding options are out of the money as of December 31, 2008 and their intrinsic value was considered as zero.

**) Represents intrinsic value of 125,556 vested and expected to vest options that are in-the-money as of December 31, 2008. The remaining 259,609 vested and expected to vest options are out of the money as of December 31, 2008 and their intrinsic value was considered as zero.

***) Represents intrinsic value of 30,946 exercisable options that are in-the-money as of December 31, 2008. The remaining 171,984 exercisable options are out of the money as of December 31, 2008 and their intrinsic value was considered as zero.

As of December 31, 2008, $1,535 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.21 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 2008 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, 2008.

The weighted-average grant-date fair value of options granted during the years 2008, 2007 and 2006 was $4.69, $7.16, and $7.35, respectively. The total intrinsic value of options exercised during the years ended December 31, 2008, 2007 and 2006, was $326, $1,052 and $1,768, respectively.

Following are the outstanding options by exercise price as of December 31, 2008:

	Outstanding			Exercisable		
Exercise price	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average remaining contractual life (years)	Weighted average exercise price
0	97,196	6.03	-	28,446	3.57	-
2.12-3.00	121,775	6.71	2.87	2,500	3.47	2.12
4.08-4.35	67,484	4.51	4.34	67,484	4.51	4.34
6.84-6.92	49,500	5.52	6.85	49,500	5.52	6.85
7.54-8.00	38,000	5.54	7.88	38,000	5.54	7.88
12.16-12.83	45,000	8.20	12.58	17,000	6.93	12.21
15.41-15.45	28,000	8.49	15.43	-	-	-
	446,955	6.46	5.10	202,930	5.01	5.64

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

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

	Year ended December 31,		
	2008	2007	2006
Cost of revenues	119	108	51
Research and development	128	123	53
Selling and marketing	240	174	102
General and administrative	452	326	376
Total stock-based compensation expense	939	731	582

e. As of December 31, 2008, 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)

[11] Earnings Per Share

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

	Year ended December 31,		
	2008	2007	2006
Net income (loss)	(25,151)	4,815	5,414
Weighted average Ordinary shares outstanding - Basic EPS	5,290,919	5,092,696	4,494,079
Dilutive effect:			
Employee stock options	-	275,896	282,377
Weighted average Ordinary shares outstanding - Diluted EPS	5,290,919	5,368,592	4,776,456
Basic earnings (loss) per share	(4.75)	0.95	1.20
Diluted earnings (loss) per share	(4.75)	0.90	1.13

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

The total numbers of options excluded from the calculation of diluted net earnings per share, as they would have an anti-dilutive effect were 446,955, 204,660 and 11,160 for the years ended December 31, 2008, 2007 and 2006, respectively.

[12] 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,		
	2008	2007	2006
Revenues based on the customer's location:			
United States	25,215	18,414	13,408
Europe (other than Germany)	16,524	11,487	7,641
Germany	7,827	5,415	3,005
Other	10,754	4,568	4,415
	60,320	39,884	28,469

	December 31,	
	2008	2007
Long-lived assets by geographic location:		
Israel	1,085	1,491
Europe	34	59
United States	971	546
	2,090	2,096

Notes to Consolidated Financial Statements

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

[13] Selected Statememnts of Operations Data

Financial income (loss), net:

	Year ended December 31,		
	2008	2007	2006
Financial income:			
Interest	$286	$1,388	$913
Dividend received on marketable securities	-	368	-
Foreign currency translation differences, net	-	1,305	396
	286	3,061	1,309
Financial expenses			
Bank charges	210	82	78
Realized loss on sale of marketable securities	-	135	-
Foreign currency translation differences, net	1,315	-	-
	1,525	217	78
	$(1,239)	$2,844	$1,231

Report of the Board of Directors

Dear Shareholders,

During 2008 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, 2008, the Board of Directors consisted of 7 members, including 2 external Directors. Board meetings focused on the global economic crisis and its impact on AVT and on strategies for profitable growth through integration of technologies and products of GMI and AVT opening up cross market selling opportunities. Furthermore, we reviewed the GMI field operations integration activities. In addition, during the year the board established the structure for compensation plans (including stock options) for the employees and managers of the company.

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 2008, we held 11 Board of Directors meetings, 7 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 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, 2008 and 2007, and the related consolidated statements of income, changes in shareholders' equity and cash flow for each of the three years ended December 31, 2008, were audited by KOST FORER GABBAY & KASIERER, a member of Ernst & Young Global.

In the Audit Committee and Board of Directors meetings held on February 19, 2009 and February 25, 2009 respectively, attended by the company's auditors and legal counsel, we discussed the 2008 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 29, 2009

Yeoshua Agassi

Members of the Board of Directors

Shlomo Amir 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 B.Sc. in Mathematics and Computer Science from Tel Aviv University, Israel, and an MBA from Boston University, Massachusetts, United States.

Yehoshua Agassi Chairman of the Board of Directors
Mr. Agassi has served as CEO & President of Scitex Corporation Ltd from 2001 until 2003 , In parallel Mr. Agassi has served as Executive Vice President of Clal Industries and Investments Ltd. one of Israels largest investment and holding companies in Israel. During 2000, Mr. Agassi served as General Manager of Leumicard Ltd., one of Israels leading credit card services owned by Bank Leumi. From 1993 until 1998, Mr. Agassi served as the General Manager of Israeli Direct Insurance Company (IDI), a direct insurer located in Tel Aviv, which he co-founded in 1993. Mr. Agassi has earned an MBA in Marketing from Bar Ilan University, as well as a B.A. in Economics from Tel Aviv University. Currently Mr. Agassi is the chairman of the board of two privately owned companies.

Nurit Nahum Mrs. Nahum joined AVT's Board of Directors in 2008. Currently Mrs. Nahum is the CEO of Ronin Investment Managing Company Ltd., a privately owned investment company. Prior to joining Ronin, she was the Chairman of the Board of Plastnir Flexible Plastic Packaging; a board member of Israel Cold Storage & Supply Company and a board member of Elran Holdings Ltd. Previous to that, Nurit Nahum was Vice President of Economic and Business Development at Packer Plada Ltd., and held several positions at Price Waterhouse Coopers, Israel, also serving as the CEO of the business consulting unit. Mrs Nahum holds an MBA degree in Finance and International Marketing from the Tel-Aviv University.

Dan Falk Mr. 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 Mr. 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.

Ofer Ne'eman Mr. Neeman was born and raised in Kibbutz Yechiam in the Western Galilee, Israel.
He joined Evergreen in 1996 as CEO and President of Evergreen, a leading private equity firm in Israel. In 1998 became co-owner together with founder Jacob Burak. In 2005 management of Evergreen was handed over to the younger generation of managers and partners. Ofer is Chairman of Beterem (Safe Kids Israel) as well as a member of the Advisory Board of The School of Government of Tel Aviv University. Ofer holds a BA in Accounting and Economics from Tel Aviv University and is a graduate of the Harvard Business School executive program.

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