

AVT-GMI Annual Report / 2009

Quote”

Partnering for Success

AVT partners tell why they choose to make AVT solutions part of their offerings

What's In and Why?

The latest trends and considerations in deploying machine vision technology in print applications

How It All Began

In Ancient China, inventors discovered the wonders of paper and printing machines

Financial Highlights

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

	2009	2008	2007
Revenues and Income			
Revenues	37,231	60,320	39,884
Gross profit	15,951	26,344	23,016
Gross margin in %	42.8%	43.7%	57.7%
Research and Development expenses, net	7,600	11,206	6,374
Selling and Marketing expenses, net	9,043	13,402	9,888
General and Administration expenses	5,891	8,427	4,709
Amortization of deferred stock-based compensation	739	939	731
Impairment of goodwill	2,045	17,192	-
Operating income (loss)	(8,916)	(23,883)	908
Operating margin in %	(24.0%)	(39.6%)	2.3%
Net income (loss)	(10,706)	(25,151)	4,815
Cash flows			
Cash flows provided by (used in) operating activities	(1,507)	(2,906)	8,233
Cash flows used in investing activities	(5,484)	(857)	(23,972)
Cash flows provided by financing activities	-	215	10,165
Balance sheet as of December 31,			
Cash and Equivalents	11,114	13,105	16,653
Total assets	30,829	45,015	73,699
Total liabilities	14,465	18,684	23,371
Total shareholders' equity	16,364	26,331	50,328
Share			
Basic earnings (loss) per share in US dollars	(2.02)	(4.75)	0.95
Share price as of December 31,	2.84 Euro	2.15 Euro	10.50 Euro
Employees			
Employees as of December 31,	225	280	309

Table of Contents;



5 / Synergy & Symbiosis

6 / Letter to Shareholders

10 / The Management

12 / Quote Magazine

22 / Management's Discussion & Analysis

46 / Financial Table of Contents

47 / Report of Independent Auditors

48 / Consolidated Balance Sheets

50 / Consolidated Statements of Operations

51 / Consolidated Statements of Change in Shareholders' Equity

52 / Consolidated Statements of Cash Flow

53 / Notes to Consolidated Financial Statements

80 / Report of the Board of Directors

81 / Members of the Board of Directors

About AVT

Advanced Vision Technology Ltd (AVT) is the world leader in the development, manufacturing, marketing and customer services of automatic inspection systems for the print industry.

It is recognized at the forefront of the packaging, labels, folding cartons and converting sectors. Today, more than 2100 AVT Print Vision systems are installed worldwide.

Graphic Microsystems, Inc. (GMI) is the world's premier supplier of closed loop color control systems, color managing and reporting software, and remote digital ink fountain control systems.

These products are sold to major commercial, semi-commercial, newspaper and specialty printers in the heat-set and coldest web-offset printing markets as well as to printing press OEMs. GMI has some 3140 installations. GMI is a subsidiary of AVT.

Now the AVT-GMI synergistic merger is creating new comprehensive process and quality control opportunities for printers worldwide.

Headquartered in Israel, with offices around the world, AVT is a public company listed on the Prime Standard of the Frankfurt Stock Exchange.

Synergy & Symbiosis

Synergy and symbiosis are the drivers of natural evolution. Successful companies develop insights and skills to mimic these extraordinary phenomena.

The completion of the AVT-GMI merger during 2009 signifies the groundwork for synergy. Now our aspiration is to deploy this synergy to strengthen the symbiosis with our clients in broadening sectors of the print industry.

From our inception, our determination to experience our clients' shop floor, technological and business challenges, has set the pace of our development. Now, changing competitive market

trends open opportunities for even greater cooperation.

What better way to describe these realities than in the words of the people who are living them every day? This year's Annual Report lets our partners, industry experts and leaders speak for themselves.



"These trends favor us in many ways, and as the first sprouts of joint sales reveal, AVT is recognized as providing printers with a jumpstart in the new environment."

Dear Shareholders, It

has been a busy year at AVT, while navigating through a troubled economy.

In the second quarter we completed the integration process with GMI, positioning us for synergistic marketing, sales and support, as well as new product development.

We simultaneously diversified product offerings while streamlining operating costs.

Organized into regional territories, these activities have strengthened our full solution positioning, pushed forward our drive into commercial printing markets, and will help us take advantage of what we hope will be healthier market conditions.

While future forecasts must be cautious following recent economic whirlwinds, there are developments that should encourage capital investments as different sectors in the printing industry prepare for renewed growth.

Furthermore, industry trends, as noted by leading analysts and industry experts, indicate greater competition in quality and pricing, yet a call for shorter runs as printers' customers seek greater differentiation in market segments, and just-in-time deliveries.

These trends favor us in many ways, and as the first sprouts of joint sales reveal, AVT is recognized as providing printers with a jumpstart in the new environment.

Key Financial Highlights

Consolidated revenues for the year ended December 31, 2009 were \$37.2 million, as compared to \$60.3 million in 2008, a decrease of 38 percent. Total revenues in Q4 were level with those of the previous two quarters. However, the total GAAP net loss increased in Q4, due primarily to impairment of intangible assets and goodwill related to the GMI acquisition and valuation allowance of deferred income tax assets.

Net loss in 2009 was \$10.7 million, compared with the net loss of \$25.2 in 2008. Fully diluted net loss per share in 2009 was \$2.02 compared with a loss of \$4.75 per share in 2008.

The integration process has resulted in measurable savings in our operating expenses. Total personnel costs have also been trimmed in R&D, without impairing development programs.

Key Market Highlights

The CPC Group is one of our loyal clients, with a number of AVT solutions installed. In 2009 CPC Haferkamp took advantage of the AVT-GMI merger to equip its new Nilpeter MO4 modular offset press for labels and packaging with AVT's PrintVision/Helios II for 100% automatic quality inspection, and GMI's Microcolor NW, the latest generation remote digital ink control solution.

In addition, the company opted for an AVT WorkFlow Link, to ensure efficient removal of defective material.

CPC's choice was made after adding up the various benefits the joint AVT-GMI package

would deliver, including outstanding print quality characterized by particularly excellent color consistency, optimal use of ink- all while featuring a high level of automation and usability. The bottom line result is dramatically reduced production costs while ensuring superior deliverables to customers.

Sometimes a celebrity client dwarfs the event, but in this particular instance, a major AVT-GMI sale to the commercial print industry deserves as much attention.

It verifies our strategy that the merger would promote AVT's offerings to this sector. Bridge publications, located in Los Angeles, the Church of Scientology's North American publishing corporation, ordered AVT/GMI's ColorQuick on-press closed loop color control system, PrintQuick automatic color-to-color register control, and PrintVision/Apollo Commercial 100% automatic inspection solution for process control and quality assurance.

It is worth noting that the commercial print market is awakening to the need for higher quality. One of the drivers, no doubt, is the competition with the web, motivating printers to prove that quality commercial print can deliver aesthetic satisfaction and clarity that is far superior.

We are also pleased to report the enthusiastic feedback we have received from the Stratus Packaging Print Group of Ohio concerning our PrintVision/Orion. First introduced in Drupa in 2008, the PrintVision/Orion is applied by Stratus to inspect individual die cut package blanks for a pharmaceutical client.

Our machine never tires... operating around the clock and literally inspects millions of packages, to Stratus's satisfaction.

Showcase Highlights

We participated successfully in two major trade shows in 2009. At Print '09 in Chicago in September, we introduced ColorQuick/Clarinos and the MicroColor/Mercury, the new generation closed loop color control and remote ink control solutions for offset print processes. A live demonstration was offered at a nearby customer site.

Our strong presence at LabelExpo Europe was acclaimed by participants and press. Our new PrintVision/Helios II and MicroColor NW remote ink control platform were recognized for increasing productivity, reducing print waste during make ready and run time, and improving press and rewinder utilization. An interesting development is the new ProMIS, the Helios II bi-directional communications with MIS systems in the print production environment.

The Human Dimension

This report to our shareholders cannot go without mention of the extraordinary professionalism, motivation and emotional intelligence exhibited by the AVT and GMI teams during the Integration process.

New operational paradigms, changes in location and responsibilities were all exponentially made challenging by the human factor - of the employees of two organizations learning to understand, appreciate and cooperate with each other for the creation of a whole that is greater than its parts. I wish to thank our employees at all levels around the globe that had the vision and determination to make this possible.

*To sum up,
we believe we are
a leaner company
moving rapidly
towards a "one-stop"
solution provider
for diverse
printing sectors.*

*We thank our
shareholders,
customers and
employees for
supporting us on
the path to new
achievements.*

Sincerely yours,



Shlomo Amir
President & CEO

The **M**anagement

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, VPR&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 high-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 a 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 & President AVT Europe

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

Mr. Shtaierman holds B.Sc. and M.Sc. degrees in Electronics and Computer Engineering from the Technion, Haifa, Israel.

Niki Bassat, V.P. Operations

Mr. Bassat joined AVT from superDimension, a medical device company, where he was Chief Operating Officer and General Manager (Israel). Before that, he was Chief Operating Officer at RaySat, a manufacturer of in-motion satellite antennas. He was the Chief Operating Officer at Power Paper a provider of micro-powered devices. He was the Chief Operating Officer at SATLYNX, a pan-European two-way satellite broadband services provider, and served as managing director of SATLYNX GmbH. Prior to that, he was the Vice President, Operations, at Gilat Satellite Networks. Mr. Bassat also worked for Tadiran Telecommunications as Plant Manager. He holds a B.Sc. in industrial engineering from the Technion: Israel Institute of Technology, and studied towards an 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, President, GMI Inc.

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.

Amir Dekel, V.P. Marketing

Amir holds a MS in Electrical Engineering in Communications and Computer Science from Polytechnic University NY, USA. For the past 8.5 years he has worked for AVT to establish an automatic inspection methodology for the labels market and as the Director of Marketing in AVT, Inc. in the US. Prior to AVT, Amir held various positions in the communications and telecommunications fields, including positions in China (GM of large telecommunication joint venture), in the US (8 years of various positions in the communications field and consumer products companies).

Growth Accelerated by Partnerships

Direct Responses

The new generation ColorQuick/Clarios and Microcolor/Mercury products introduced in 2009 are precisely directed at today's press-room challenges.

ColorQuick was the pioneer of on-press closed-loop color control solution using an ISO standard spectrophotometer for accurate color measurements. Now the new generation is a dramatic step forward with a more intuitive touch screen interface and faster response. The number of views has grown, and ColorQuick/Clarios offers a new Print Condition view, Tone value view, new Setup views, Color Conformance view, and an updated Preview. The new, highly flexible hardware and software package is ideally suited to modern press rooms, dramatically increasing print efficiency.

Targeting Even Greater Accuracy

The new Microcolor/Mercury is another great boost for quality printing and productivity, with its completely redesigned operator con-

sole, and dozens of new features. In fact, it is the most adaptable remote digital ink control solution in the industry. Current Microcolor users were delighted to learn they can simply upgrade their existing solution to the new generation model.

“GOSS’s industry leadership is derived from innovative technology and its application to customer requirements.

Our partnership with AVT makes an important contribution to this goal by productivity increase, waste reduction and promoting the highest standards of quality.”

Theo Buchmeyer /
Managing Director / GOSS Nantes and Morataire



Making the most of Pro- duction

“THE COMEXI GROUP for converting solutions has grown in the last decades thanks to alliances and partnerships that expand the diversity, value and leadership of our offerings.

AVT, with whom we are proud to partner, fits in to this mission by ensuring quality and competitiveness through advanced technology fine-tuned to customer goals.”

Manel P. Xifra / Chairman and CEO / Comexi Group

Cutting Costs, Improving Quality

The new PrintVision/Helios II is an example of AVT's continuous drive for excellence.

This complete new product now features on-line verification of barcodes, data-matrix codes and variable data, seamlessly integrated with the 100% quality control features that have made the Printvision/Helios a success.

Meeting FDA Requirements

The new system also supports the latest ePedigree FDA initiative to track and trace pharmaceuticals from manufacturer to customers, and

to protect the latter from contaminated or counterfeit medicines or drugs.

Getting Together with MIS Systems

Now control over raw materials and production is better than ever, with AVT's ProMIS, a bi-directional communications with customers' Management Information Systems. This interaction shortens set-up, streamlines automation even further, and saves time by doing away with re-entering of data.

Another time-saver is the press-to-rewinder features of the new PrintVision/Helios II.

Why machine vision?

“Machine vision-based techniques, more so than other sensor-based controls, are recognized as having the ability to build quality into the printing process... The driving force behind these systems is the 20-40% reductions in print waste...”

In addition... other advantages include the fact that such systems permit presses to run faster, make a substantial impact on quality and allow presses to be set up faster.”

Nelio Zuech /
President / Vision Systems International

From Start to Finish

AVT and GMI's line of solutions is designed to meet the needs of every printer and production workflow, beginning with job verification and remote inking control during set-up, through in-line automatic inspection, press and process control solutions, and quality assurance for the finishing line. In summary, AVT and GMI support the entire print production workflow.

The Impact of Quality

AVT's PrintVision family pioneered machine-vision based inspection for the print shop floor. Printers entered a new era, as they did away with the human distractions and inattention that could adversely impact the quality and profitability of their operation. PrintVision became a differentiator for printers, enabling them to assure customer satisfaction while reducing production costs. This in turn generated more business, making PrintVision a growth accelerator.

Addressing More Market Needs

AVT is a long recognized leader in automatic inspection systems for web print applications in the packaging, labels, folding cartons and converting sectors.

GMI targets leading commercial, semi-commercial, newspaper and specialty printers in the head-set and coldest web-offset printing markets as well as printing press OEMs.

Now fully integrated, the unified company is addressing more needs than ever through synergies of technologies and market know-how.





Should I or Shouldn't I?

“Shorter print runs, growing quality demands, increased pressure on profit margins and intensifying competition have led printers to search for innovative technologies to reduce internal waste and increase product quality. The market awareness and acceptance of machine vision-based solutions is growing as more and more printers adopt this technology.”

Gal Shamri / President / GMI

An Educated Market Demands Innovation

The first marketing stages of machine vision in the print industry were primarily educational. Now the main challenge is to provide better integration into the printer's workflow and to provide more added value features such as in-line color measurement and press control.

What and How

Printers considering machine vision must first understand what are the specific requirements of their operations, such as: What are the main print defects to be detected? On which presses or finishing machines? Is on-press 100% inspection needed? What is the preferred workflow for removing defective material? Is 100% quality assurance necessary on the finishing side as well?

Finally, full production workflow analysis is

critical, since vision-based solutions can be integrated at several points along the production process. For example, defects detected on press by AVT's PrintVision systems can be automatically removed downstream, on a re-winder using AVT's Workflow Link.

Testing the Water

Investment in capital equipment is a solution if it performs on the production floor. This may seem to be basic, but in many instances lab developments and hyped-up marketing material and sales forces can obscure this simple fact.

AVT designs each system to its customers' applications, through an intensive learning process. A global support team then ensures optimized implementation.

The results speak for themselves - through repeat orders and leading OEMs who partner with AVT.

From Rags to Riches

The Kings Court

The word paper has its origin in the Greek term for the ancient Egyptian writing material called papyrus, which was made from beaten strips of the papyrus plant. In approximately the 2nd century AD, the first pulp making process was developed in China by the Han court eunuch Cai Lun, using such materials as tree bark, hemp, rags and other sources. Papermaking is considered one of the Four Great Inventions of Ancient China.

The first paper mill in Europe was built in 1009.

The Chinese Lead the Way

By AD 593, the first printing press was invented in China, and the first printed newspaper, Kaiyuan Za Bao, was made available in Beijing in AD 713. The technology was based on woodblock printing.

Around AD 1040 the first known movable type system was created in China by Bi Sheng out of porcelain. Sheng used clay type, which broke easily; Wang Zhen later carved a more durable type from wood by AD 1298.

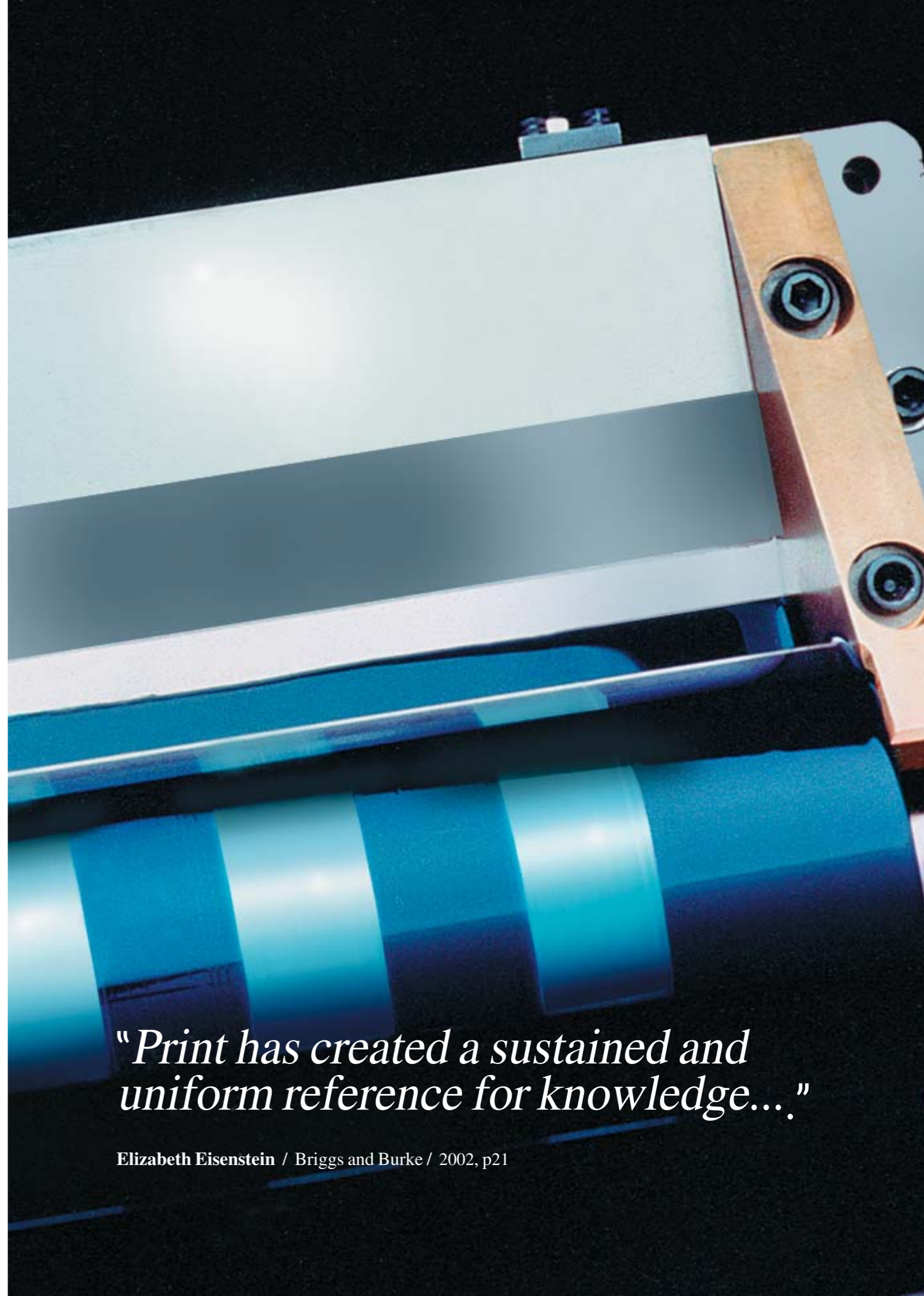
Gutenberg Introduces the Modern Age

In Europe, around 1450, Johannes Gutenberg introduced an independent invention: movable type, along with innovations in casting the type based on a matrix and hand mould. Gutenberg was the first to create his type pieces from an alloy of lead, tin and antimony - the same components still used today!

Racing Ahead

In the 21st century, printers can choose and specialize in printing techniques ranging from offset, rotogravure, and flexo, to digital print technologies. While the web has changed certain areas of print expression, the need for printed material in labeling, packaging and various commercial materials is growing exponentially.

Machine Vision technology-based process and quality control is the next major stage in the fabulous history of printing.



"Print has created a sustained and uniform reference for knowledge..."

Elizabeth Eisenstein / Briggs and Burke / 2002, p21

Management's Discussion & 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.

Management's Discussion & 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 Advanced 100% automatic inspection inspection applications	Advanced 100% automatic inspection inspection applications 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 A unique combination of 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 & 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 to automatically and remotely control ink fountain key positions from a remote workstation.
ColorQuick / Clarios	Commercial and newspaper printing/ Web Offset	Closed loop color control system that utilizes a spectrophotometer to measure colors that have been printed by a press. The CQ system converts spectrophotometric data to industry standard Status T or E ink density information and then compares the measured value to pre-defined job targets or standards. The system will automatically make adjustments to the press ink keys so that quality standards are met.
PrintQuick	Commercial printing / Web Offset	A sophisticated automatic closed loop color-to-color register control designed for commercial presses.
RibbonQuick	Commercial printing / Web Offset	An automatic system that determines and controls print-to-cut and print-to-fold position of web offset presses.

Management's Discussion & 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, 2009 approximately 2,100 PrintVision platforms, 3,140 Microcolor systems and 850 ColorQuick systems were installed worldwide. No distributor or end-user accounted for more than 10% of revenues in 2009 and 2008.

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 channel for Europe. AVT EMEA (Belgium) SCRL was established in July 2007 consolidating and controlling our European customer support 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.

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

The study determined the respective fair value of the various intangible assets and Goodwill as follows:

- \$9,766 thousand were allocated to Technology and will be amortized over the useful life estimated at 7 years commencing at the closing date, out of which \$4,585 thousand impaired in the fourth quarter of 2008 and additional \$1,620 thousand impaired in the fourth quarter of 2009 (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 was 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 commencing at the closing date, out of which \$871 thousand impaired in the fourth quarter of 2009 (See also critical accounting policies).

- \$18,412 thousand were allocated to Goodwill, out of which \$16,367 thousand impaired in the fourth quarter of 2008 and additional \$2,045 thousand impaired in the fourth quarter of 2009 (See also critical accounting policies).

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 entered the 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 terms of market segments addressed and process control solutions offered to the traditional markets of AVT and GMI. 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 2009 the European currency

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

increased in value relative to the US Dollar by approximately 3.5%. In Israel, during 2009, the New Israel Shekel ("NIS") increased in value relative to the US Dollar by 0.7%.

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's 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.

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

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

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 press control, Closed Loop Color control (CLC), color management and reporting software and provide customer support directly and through

our wholly-owned subsidiaries in the United States and Europe. Each subsidiary employs local marketing, sales and customer support personnel. Worldwide marketing efforts are coordinated by the responsible marketing managers, who are based at Company headquarters in Israel and in the Company's subsidiaries in the US.

Approximately 34 people are engaged in the Company's worldwide selling and marketing efforts, which include participation in various trade shows and conventions, publications and trade press, demonstrations performed in Company facilities and daily contact with customers by sales personnel.

Critical Accounting Policies

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

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

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

In the normal course of business, we do not provide a right of return to our customers. Sales agreements with specific acceptance terms are not recognized, until the customer has confirmed in writing that the product or service has been accepted. Revenues from maintenance and professional services are recognized ratably over the contract period, or as services are performed.

When transactions involve multiple elements, revenue is allocated to the elements based on the fair value of each element in the arrangement. The best evidence of fair value is the price of a deliverable when it is regularly sold on a standalone basis. Fair value is limited to (a) the price charged for a deliverable when it is sold separately or (b), for a deliverable not yet being sold separately, the price established by management having the relevant authority.

Inventory Valuation. At each balance sheet date, we evaluate our inventory balance for excess quantities and obsolescence. This evaluation includes analysis of sales

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

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 conducted during the fourth quarter of 2009 and 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 2009 and 2008 we performed our annual impairment test of acquired intangible assets and goodwill as

prescribed by ASC 350 and ASC 360 (formally known as SFAS No. 142, "Goodwill and Other Intangible Assets," and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," respectively) 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 \$1,620 thousand and of \$4,585 thousand against Technology intangible asset in the fourth quarter of 2009 and 2008, respectively, a non-cash impairment charge of \$871 thousand against Customer Relationships and Trademarks/Trade names intangible assets in the fourth quarter of 2009 and a non-cash impairment charge of \$2,045 thousand and of \$16,367 thousand against goodwill in the fourth quarter of 2009 and 2008, respectively. The reduction in carrying value of GMI's goodwill and other intangible assets is attributable to decline in the Company's forecasted business outlook, which management attributes to the impact of the global economic recession. 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.

ASC 350 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

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

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, 2009, the carrying value of our long-lived asset was \$1,740 thousand including Technology & Patents, Customer Relationships and Trademarks/Trade names intangible assets related to GMI acquisition

We are required to assess the impairment of long-lived assets, tangible and intangible, other than goodwill, ASC 360 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 carrying amount over the fair value. We measure fair value using discounted projected future cash flow.

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

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

We record income taxes using the asset and liability approach. Deferred income tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and net operating loss and tax credit carry forwards. Our financial statements contain tax assets which have arisen as temporary differences between book and tax accounting. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We have considered future taxable income, prudent and feasible tax planning strategies and other available evidence in determining the need for a valuation allowance.

We evaluate all of these factors to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. If the realization of deferred tax assets in the future is considered more likely than not, an adjustment to the deferred tax assets would increase net income in the period such determination was made.

Our effective tax rate may vary from period to period based on changes in estimated taxable income or loss, changes in the valuation

allowance, changes in state or foreign tax laws, future expansion into geographic areas with varying country, state and local income tax rates, deductibility of certain costs and expenses by jurisdiction and as a result of acquisitions, divestitures and reorganizations.

Stock-Based Compensation. We account for stock-based compensation in accordance with the provisions of ASC 718 (formally known as SFAS No. 123(R), "Share-Based Payment"). Under the fair value recognition provisions of ASC 718, 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,

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

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,		
	2009	2008	2007
Inflation (deflation)	3.9%	3.8%	3.4%
Revaluation	(0.7%)	(1.1%)	(9.0%)
Inflation gap	4.6%	4.9%	12.4%

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

Organizational Structure

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

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

Management's Discussion & 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, 2009, 2008 and 2007 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		
	2009	2008	2007
Revenues	37,231	60,320	39,884
Cost of revenues	21,280	33,976	16,868
Gross profit	15,951	26,344	23,016
Gross margin in %	42.8%	43.7%	57.7%
Operating expenses:			
Research and development, net	7,600	11,206	6,374
Selling and marketing	9,043	13,402	9,888
General and administrative	5,891	8,427	4,709
Acquired In Process R&D	-	-	1,137
Restructuring	288	-	-
Impairment of goodwill	2,045	17,192	-
Total operating expenses	24,867	50,227	22,108
Operating income (loss)	(8,916)	(23,883)	908
Financial income (expense), net	(63)	(1,239)	2,844
Profit (loss) before taxes on income	(8,979)	(25,122)	3,752
Taxes on income (tax benefit)	1,727	29	(1,063)
Net income (loss)	(10,706)	(25,151)	4,815

Management's Discussion & 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, 2009, 2008 and 2007 expressed as a percentage of total revenues:

	Year ended December 31,		
	2009	2008	2007
Revenues	100%	100%	100%
Products	75.5	84.3	89.7
Services	24.5	15.7	10.3
Cost of revenues	57.2	56.3	42.3
Gross profit	42.8	43.7	57.7
Operating expenses:			
Research and development, gross	22.7	20.0	17.0
Less - grants	(2.3)	(1.4)	(1.0)
Selling and marketing	24.3	22.2	24.8
General and administrative	15.8	14.0	11.8
Acquired In Process R&D	-	-	2.8
Restructuring	0.8	-	-
Impairment of goodwill	5.5	28.5	-
Total operating expenses	66.8	83.3	55.4
Operating income (loss)	(24.0)	(39.6)	2.3
Financial income (expense), net	(0.2)	(2.1)	7.1
Profit (loss) before taxes on income	(24.2)	(41.7)	9.4
Taxes on income (tax benefit)	4.6	0.0	(2.7)
Net income (loss)	(28.8)	(41.7)	12.1

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

The results of 2009 and 2008 include non-cash impairment charge of \$2,045 thousand and \$17,192 thousand, respectively against Goodwill and non-cash impairment charge of \$1,620 thousand and \$4,585 thousand respectively against Technology intangible asset and in 2009 non-cash impairment charge of \$871 thousand against Customer Relationships and Trademarks/Trade Names. Out of the 2008 impairment charge against Goodwill, \$16,367 thousand are related to the GMI acquisition and \$825 thousand to Geiger Vision Systems (GVS) acquired in 2002.

In addition, the annual schedule of amortization of acquired intangible assets in 2009 and 2008 is comprised of amortization of Technology of \$598 thousand and \$1,395 thousand, respectively, Customer Relationship and Trade Marks of \$321 thousand and \$79 thousand, respectively (as well as amortization of Order Back-Log of \$698 thousand in 2008). Technology and Trade Marks are amortized ratably over 7 and 10 years, respectively and Customer Relationship is amortized using the accretion method over 10 years commencing from the date of closing on 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 assets of \$4,536 thousand in 2009 and \$21,777 thousand in 2008, annual amortization of acquired intangible assets of \$919 thousand in 2009 and \$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 the fourth quarter of 2007). In addition, proforma consolidated statements of income excludes stock-based compensation expenses of \$739 thousand in 2009 and \$939 thousand in 2008 (compared with \$731 thousand in 2007), extraordinary GMI restructuring and integration costs of \$936 thousand in 2009 and \$1,615 thousand in 2008 (compared with \$28 thousand in 2007), for each of the years ended December 31 2009, 2008 and 2007 in thousands US Dollars:

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

Year ended December 31,

	2009		2008		2007
	GAAP	Adjustments	Non GAAP	Non GAAP	Non GAAP
Revenues	37,231		37,231	60,320	39,884
Cost of revenues	21,280	2,315	18,965	27,847	16,411
Gross profit	15,951	2,315	18,266	32,473	23,473
Gross margin in %	42.8%		49.1%	53.8%	58.9%
Operating expenses:					
Research and development, net	7,600	369	7,231	10,741	6,251
Selling and marketing	9,043	1,441	7,602	12,236	8,970
General and administrative	5,891	672	5,219	6,876	4,355
Restructuring	288	288	-	-	-
Impairment of goodwill	2,045	2,045	-	-	-
Total operating expenses	24,867	4,815	20,052	29,853	19,576
Operating income	(8,916)	7,130	(1,786)	2,620	3,897
Financial income (expense), net	(63)		(63)	(1,239)	2,844
Profit before taxes on income	(8,979)	7,130	(1,849)	1,381	6,741
Taxes on income (tax benefit)	1,727		1,727	29	(1,063)
Net income (loss)	(10,706)	7,130	(3,576)	1,352	7,804

Year ended December 31, 2009, compared with year ended December 31, 2008

The year ended December 31, 2009 was a challenging year in which we confronted and dealt with the effects of the global economic recession. It was a year of consolidation and of restructuring measures aimed to streamline our operations worldwide in light of the troubled business environment. We believe that by year end our company is better positioned to quickly resume growth once the economic conditions in our markets improve.

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

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 2009 totaled \$37.2 million 38.3% lower than the \$60.3 million generated in 2008.

Revenues in the fourth quarter of 2009 were \$9.1 million the same as the revenues in Q3 2009 and 22.6% less than in Q4 2008.

AVT product line revenues in 2009 were \$21.1 million representing a decrease of 30.4% compared with revenues of \$30.3 million in 2008.

GMI product line revenues in 2009 were \$16.1 million representing a decrease of 46.2% compared with revenues of \$30.0 million in 2008.

The decrease in total revenues is the result of the weak market conditions throughout 2009.

Revenues from services are generated from maintenance contracts; time and material charges; consulting and training fees, installation and sales of spare parts. We recognize revenues over the contractual period or as services are performed. Service revenues in 2009 totaled \$9.1 million (out of the total revenues of \$37.2 million) a decline of 3.7% compared with the \$9.5 million generated in 2008. The decrease in service revenues is attributable to the overall industry lower business activity.

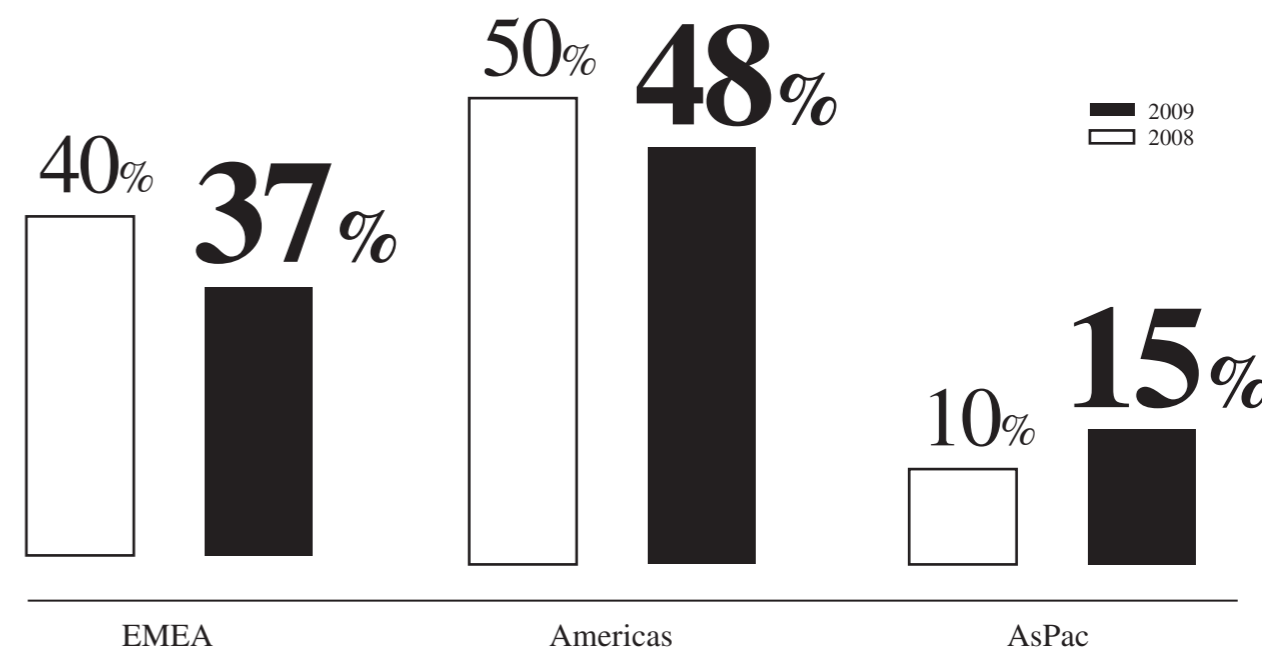
Service orders received during 2009 were \$8.8 million, 5.3% less than in 2008. The service orders, not yet recognized as revenues, will be recognized ratably over the contractual period.

During 2009 order booking totaled \$35.3 million representing a decrease of 31.5% over 2008 attributable to the global economic recession. The ratio of order booking to revenues in 2009 was 94.7% compared with 83.8% in 2008.

As of December 31, 2009 order backlog totaled \$11.5 million, a decrease of 18.2% compared with the balance at December 31, 2008 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 2010, while the remainder will become revenue in the proceeding three quarters.

Management's Discussion & 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, 2009 and 2008:



In 2009 the American market contributed 48% of total revenues compared with 50% in 2008 while EMEA (Europe, Middle East & Africa) contributed only 37% of total revenue compared with 40% in 2008. Revenues generated in Asia-Pacific contributed 15% of total revenues compared with 10% in 2008. The increase in Asia-Pacific contribution is attributable to the relative economic strength in this region.

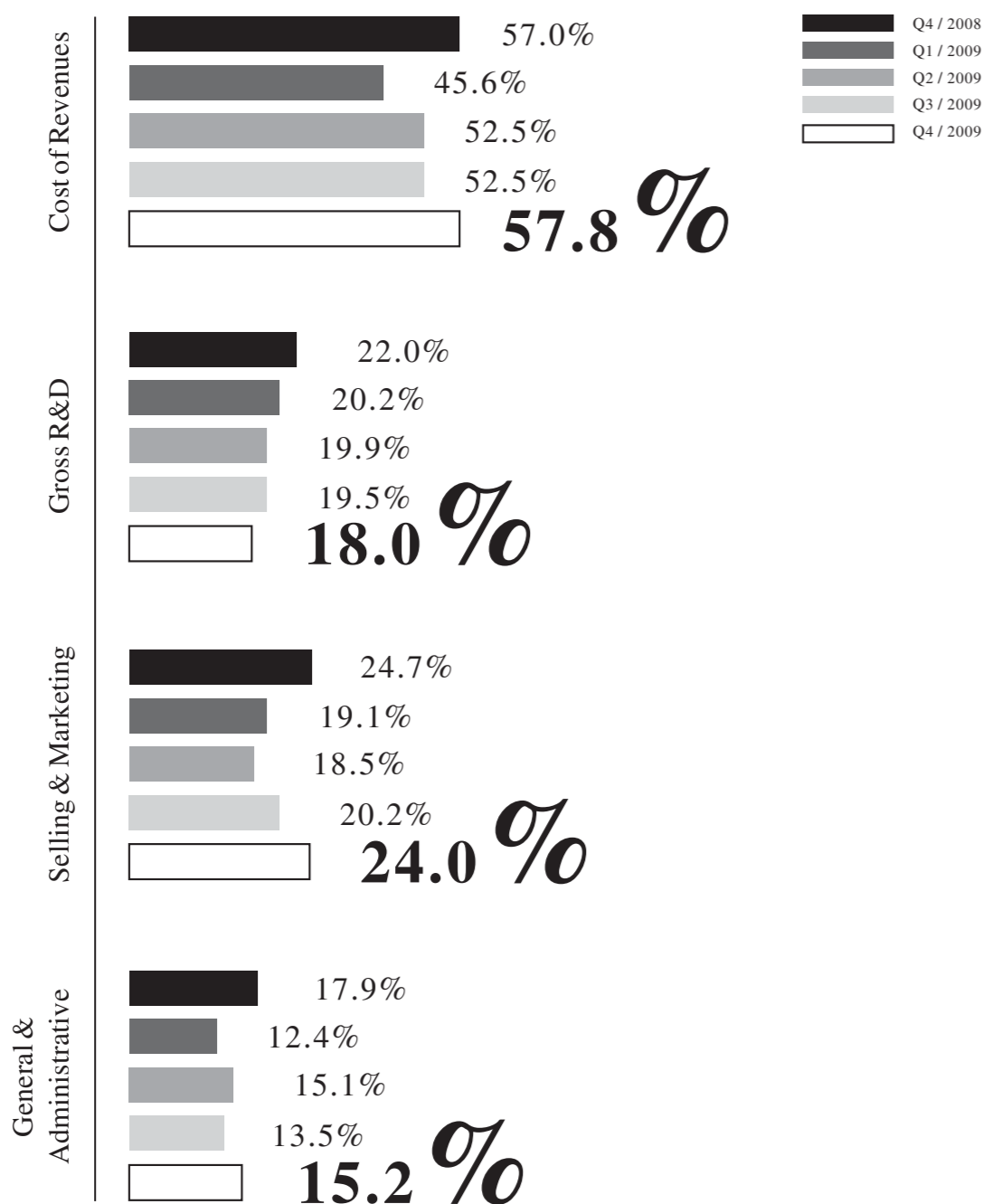
Cost of Revenues / Gross Profit

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 2009 was 42.8% compared with 43.7%, in 2008. Proforma gross margin in 2009 (excluding the impact of non-cash impairment charge, amortization of acquired intangible assets, stock based compensation expense and extraordinary GMI integration costs) was 49.1% compared with proforma gross margin of 53.8% in 2008. The decrease is due primarily to the impact of lower volume of sales on gross margin, the higher proportion of service revenues in 2009 which carry lower margins relative to products and the unfavorable impact of the Euro and NIS exchange rates relative to the US Dollar. 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 & 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 restructuring and integration costs) for each of the five quarters ended 31.12.2009, 30.9.2009, 30.6.2009, 31.3.2009 and 31.12.2008 expressed as a percentage of total revenues.



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

Research and Development

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 2009, net research and development expenses decreased to \$7,600 thousand, 32.2% less than in 2008 (\$11,206 thousand). The gross costs of research and development are partially offset by government grants. In 2009 total government grants and participation recorded were \$848 thousand compared with \$842 thousand recorded in 2008.

Proforma net research and development expenses in 2009 (excluding the impact of extraordinary GMI integration costs and stock-based compensation expense) decreased by 32.7% to \$7,231 thousand compared to \$10,741 thousand 2008. This decrease is mainly attributed to reduction in total personnel costs (including headcount and compensation), closure of Sunnyvale office, rationalization of development programs and tight expense control.

Selling and Marketing

In 2009, selling and marketing expenses decreased to \$9,043 thousand, 32.5% less than in 2008 (\$13,402 thousand). Proforma selling and marketing expenses in 2009 (excluding the impact of non-cash impairment charge, amortization of acquired intangible assets, stock based compensation expense and extraordinary GMI integration costs) decreased by 37.9% to \$7,602 thousand compared to \$12,236 thousand in 2008. This decrease is mainly attributed to reduction in total personnel costs (including headcount and

compensation), cut back in various marketing activities, decrease in revenue-based commission payments and tight expense control.

General and Administrative

In 2009, general and administrative expenses decreased to \$5,891 thousand, 30.1% less than 2008 (\$8,427 thousand). Proforma expenses in 2009 (excluding the impact of stock-based compensation expense and extraordinary GMI integration costs) decreased by 24.1% to \$5,219 thousand compared to \$6,876 thousand in 2008. This decrease is mainly attributed to reduction in total personnel costs (including headcount and compensation), closure of Sunnyvale office and lower general expenditures.

Stock-Based Compensation

Based on ASC 718 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. The measurement of the benefit is based on the Monte Carlo simulation. Total stock-based compensation expense recorded during 2009 was \$739 thousand compared with \$939 thousand in 2008.

Operating and Net Income

Net loss for the full year ended December 31, 2009 was \$10,706 thousand or a loss of \$2.02 per share (diluted) compared with net loss of \$25,151 thousand or a loss of \$4.75 per share (diluted) in 2008. Consolidated proforma net income for 2009 (excluding the impact of non-cash impairment charges, amortization of acquired intangible

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

assets, stock-based compensation expense and extraordinary GMI restructuring and integration costs), was a loss of \$3,576 thousand compared with proforma net income of \$1,352 thousand in 2008.

Consolidated net income for 2009 includes valuation allowance of \$1,660 thousand against deferred income tax assets compared with a valuation allowance of \$629 thousand recorded for 2008.

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 restructuring and integration expenses totaled \$7,130 thousand in 2009 compared with a total of \$26,503 thousand in 2008.

Consolidated proforma operating income (excluding all expense items cited above) declined from a profit of \$2,620 thousand in 2008 to a loss of \$1,786 thousand in 2009. The decrease in proforma EBIT in 2009 is due primarily to lower product revenues coupled with lower gross margin. Consolidated Proforma operating expenses were 53.9% of revenues in 2009 compared with 49.5% in 2008.

Proforma EBITDA in 2009 (excluding stock-based compensation expenses and extraordinary GMI restructuring and integration costs) declined from a profit of \$3,460 thousand in 2008 to a loss of \$962 thousand in 2009.

Financial Income (expense), net

Financial expense is comprised of interest income incurred on time deposits less interest

expenses on lines of credit and exchange rate differences. Net financial expenses for 2009 were \$63 thousand compared with net expenses of \$1,239 thousand for 2008. The decrease in financial expenses from previous year is attributable primarily to the devaluation of the Israeli Shekel against the US Dollar. Financial income in 2009 accounted for \$17 thousand compared with \$282 thousand in 2008. An additional net expense of \$80 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. For AVT product line we conducted a Transfer Pricing study during 2006 in the United States. For AVT and GMI product lines we conducted Transfer Pricing study during 2008 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 2009, in light of the continued economic slowdown 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 \$1,660 thousand recorded against our deferred income tax assets (compared with a valuation allowance of \$629 thousand recorded at the end of 2008).

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

Liquidity and Capital Resources

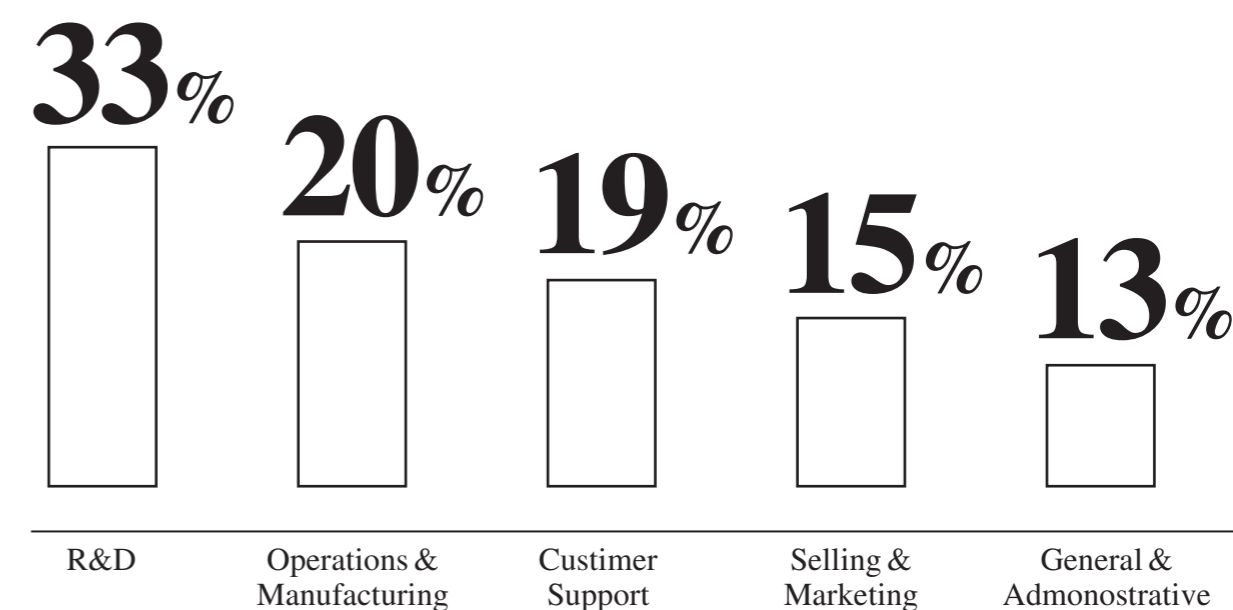
As of December 31, 2009 our total current assets were \$25.3 million, including a total cash balance and short term deposits of \$11.1 million compared with cash and financial investment balance of \$13.1 million on December 31, 2008. During 2009, \$1,507 thousand were used in operating activities compared with \$2,906 thousand used in operating activities in 2008. Our 2009 net capital expenditures on fixed assets were \$484 thousand compared with \$857 thousand used during 2008. The company did not generate any cash from financing activities in 2009 compared with net cash provided from financing activities of \$215 thousand provided in 2008.

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, 2009 were 54 days compared with 53 days for the year ended December 31, 2008.

Employees

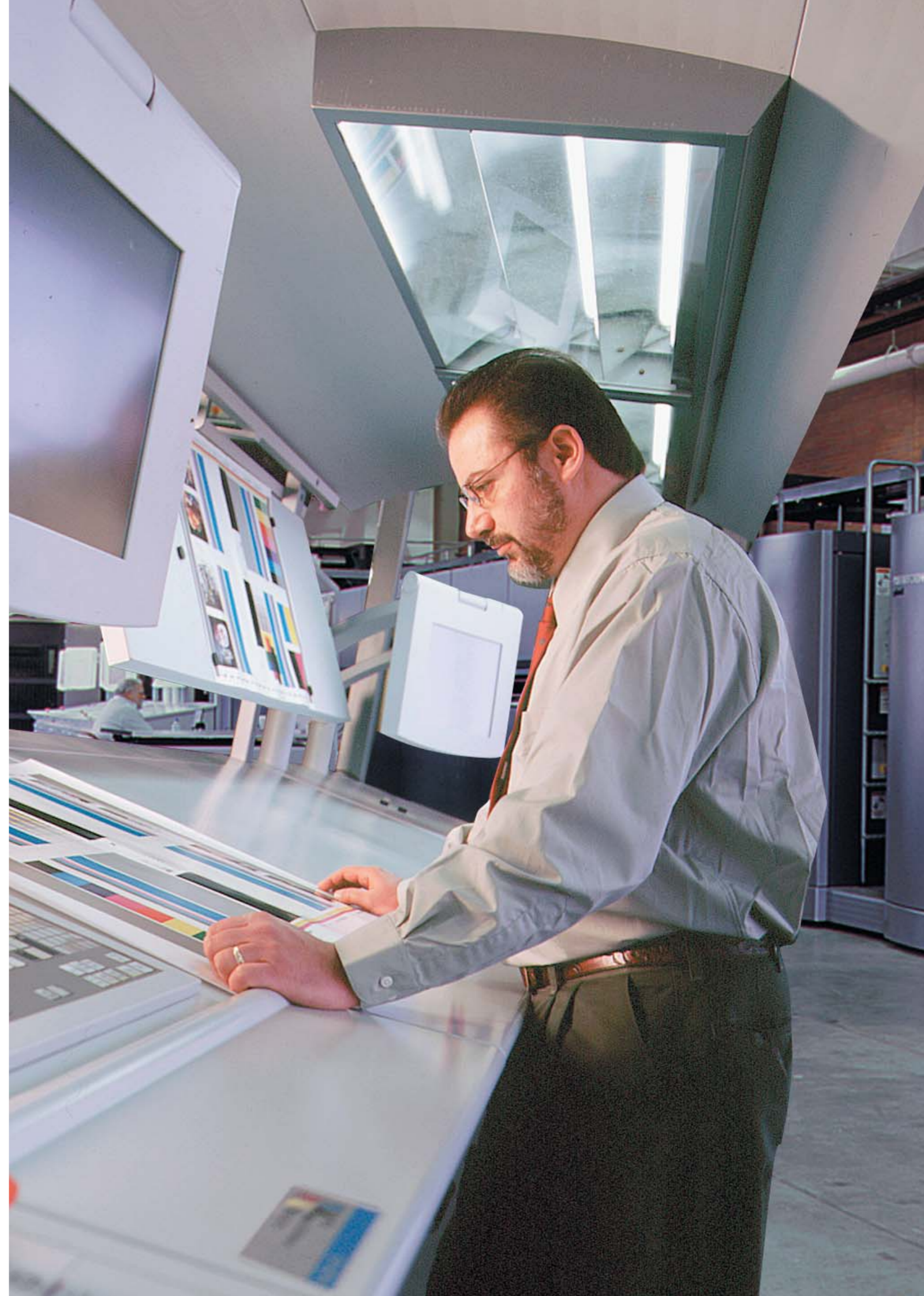
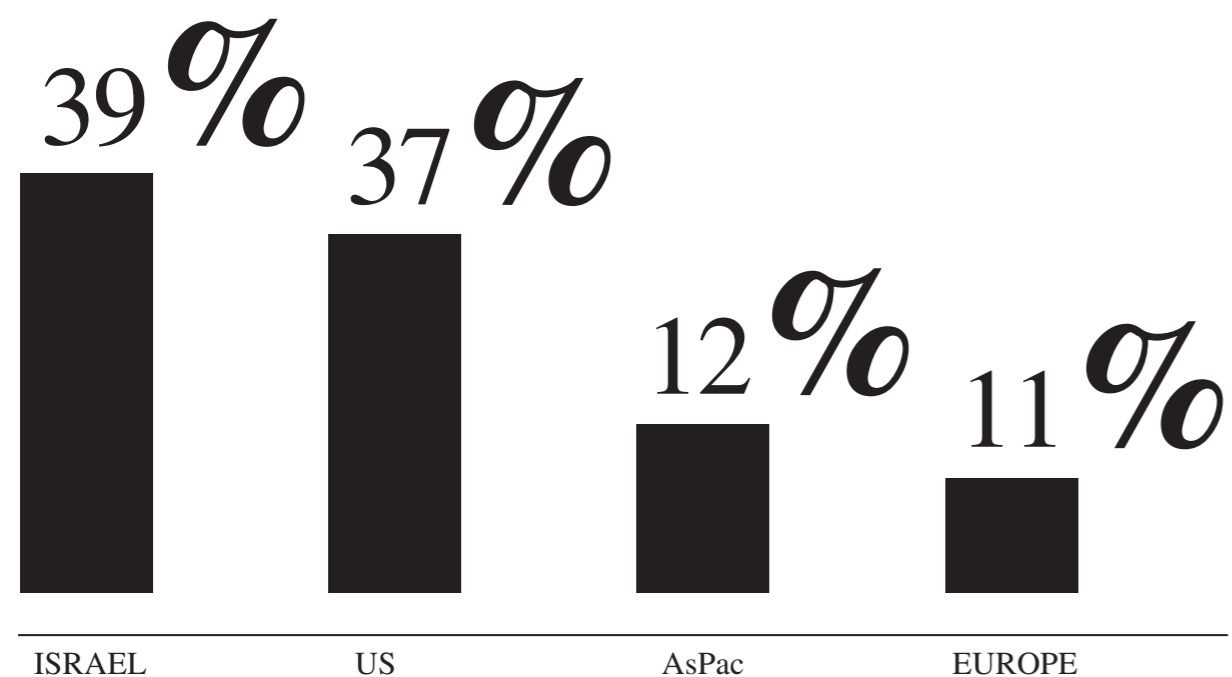
Our employees consistently remain our major asset, committed to the drive for technological leadership and outstanding customer service. Our dedicated team has repeatedly demonstrated that it shares our vision, and has the motivation, innovation and commitment to customer satisfaction that are the key ingredients of healthy growth. On December 31, 2009, 225 people were employed by us worldwide compared with 280 people we employed at December 31 2008.

The breakdown of employees by activity is as follows:



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

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



Financial Table of Contents

47 / *Report of Independent Auditors*

48-49 / *Consolidated Balance Sheets*

50 / *Consolidated Statements of Operations*

51 / *Statements of Changes in Shareholders' Equity*

52-53 / *Consolidated Statements of Cash Flow*

54-79 / *Notes to consolidated financial statements*

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, 2009 and 2008, 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, 2009. 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, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel
March 25, 2010

Kost. Forer Gabbay and Kasierer
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Consolidated

Balance Sheets

	U.S. dollars in thousands December 31,	
	2009	2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$6,114	\$13,105
Short term deposits	5,000	-
Trade receivables (net of allowance for doubtful accounts as of \$710 and \$695 as of December 31, 2009 and 2008, respectively)	5,554	8,688
Inventories	6,017	7,133
Other accounts receivable and prepaid expenses	2,638	3,242
Deferred income taxes	-	1,191
Total current assets	25,323	33,359
LONG-TERM ASSETS:		
Deferred income taxes	-	469
Severance pay fund	2,015	1,901
Total long-term assets	2,015	2,370
PROPERTY AND EQUIPMENT, NET	1,751	2,090
OTHER ASSETS:		
Intangible assets, net	1,740	5,151
Goodwill	-	2,045
Total other assets	1,740	7,196
Total assets	\$30,829	\$45,015

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) Year ended December 31,	
	2009	2008
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	\$1,475	\$1,658
Employees and payroll accruals	1,891	3,178
Customer advances and deferred revenues	3,672	5,943
Accrued expenses and other liabilities	4,455	4,781
Total current liabilities	11,493	15,560
ACCRUED SEVERANCE PAY	2,972	3,124
SHAREHOLDERS' EQUITY:		
Share capital:		
Ordinary shares of New Israeli Shekels (NIS) 2 par value:		
30,000,000 shares authorized at December 31, 2009 and 2008;		
6,296,898 shares issued at December 31, 2009 and 2008; 5,320,349 and		
5,306,795 shares outstanding at December 31, 2009 and 2008, respectively	3,402	3,402
Additional paid-in capital	61,771	61,054
Treasury shares at cost - 976,549 and 990,103 shares as		
of December 31, 2009 and 2008, respectively	(8,229)	(8,343)
Accumulated deficit	(40,580)	(29,782)
Total shareholders' equity	16,364	26,331
Total liabilities and shareholders' equity	\$30,829	\$45,015

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,

	2009	2008	2007
Revenues:			
Products	\$28,121	\$50,861	\$35,776
Services	9,110	9,459	4,108
Total Revenues	37,231	60,320	39,884
Cost of revenues:			
Products	12,543	23,244	10,616
Services	8,737	10,732	6,252
Total Cost of revenues	21,280	33,976	16,868
Gross profit	15,951	26,344	23,016
Operating expenses:			
Research and development	8,448	12,048	6,777
Less - grants	(848)	(842)	(403)
Selling and marketing	9,043	13,402	9,888
General and administrative	5,891	8,427	4,709
Acquired in-process research and development	-	-	1,137
Restructuring	288	-	-
Impairment of goodwill	2,045	17,192	-
Total operating expenses	24,867	50,227	22,108
Operating income (loss)	(8,916)	(23,883)	908
Financial income (expense), net	(63)	(1,239)	2,844
Income (loss) before taxes on income	(8,979)	(25,122)	3,752
Taxes on income (tax benefit)	1,727	29	(1,063)
Net income (loss)	\$(10,706)	\$(25,151)	\$4,815
Basic earnings (loss) per ordinary share	\$(2.02)	\$(4.75)	\$0.95
Diluted earnings (loss) per ordinary share	\$(2.02)	\$(4.75)	\$0.90

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 Shareholders' equity
Balance as of January 1, 2007	\$3,402	\$55,215	\$(14,815)	\$26	\$(8,563)		\$35,265
Adoption of FASB interpretation No. 48	-	-	-	-	(622)		(622)
Opening balance at January 1, 2007 as adjusted	3,402	55,215	(14,815)	26	(9,185)		34,643
Issuance of treasury shares upon exercise of options	-	(162)	856		(124)		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	60,196	(8,776)	-	(4,494)		50,328
Issuance of treasury shares upon exercise of options	-	(81)	433		(137)		215
Stock-based compensation related to options granted to employees	-	939	-		-		939
Net loss	-	-	-	-	(25,151)	\$(25,151)	(25,151)
						\$(25,151)	
Balance as of December 31, 2008	3,402	61,054	(8,343)	-	(29,782)		\$26,331
Issuance of treasury shares upon exercise of options	-	(22)	114		(92)		-
Stock-based compensation related to options granted to employees	-	739	-		-		739
Net loss	-	-	-	-	(10,706)	\$(10,706)	(10,706)
						\$(10,706)	
Balance as of December 31, 2009	\$3,402	\$61,771	\$(8,229)	\$-	\$(40,580)		\$16,364

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

Consolidated

Statements of Cash Flows

	U.S. dollars in thousands Year ended December 31,		
	2009	2008	2007
Cash flows from operating activities:			
Net income (loss)	\$(10,706)	\$(25,151)	\$4,815
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Stock-based compensation related to options granted to employee	739	939	731
Realized loss on marketable securities, net	-	-	135
Depreciation of property and equipment	823	840	457
Amortization of intangible assets	919	2,172	1,093
Capital loss	-	23	-
Acquired in-process research and development	-	-	1,137
Impairment of goodwill and other intangible assets	4,537	21,777	-
Amortization of marketable debt securities premium and accretion of discount	-	-	(7)
Decrease in trade receivables, net	3,134	811	364
Decrease (increase) in inventories	1,116	(965)	(618)
Decrease (increase) in other accounts receivable and prepaid expenses	604	173	(893)
Decrease (increase) in deferred income taxes, net	1,660	-	(1,761)
Decrease in trade payables	(183)	(284)	(898)
Increase (decrease) in employees and payroll accruals	(1,287)	(814)	1,255
Decrease in customer advances and deferred revenues	(2,271)	(1,028)	(414)
Increase (decrease) in accrued expenses and other liabilities	(326)	(1,515)	2,553
Increase (decrease) in accrued severance pay, net	(266)	116	284
Net cash provided by (used in) operating activities	(1,507)	(2,906)	8,233
Cash flows from investing activities:			
Investment in short-term deposit	(5,000)	-	-
Proceeds from redemption of marketable securities	-	-	8,500
Proceeds from sale of available for sale marketable securities	-	-	1,406
Purchase of available for sale marketable securities	-	-	(548)
Purchase of property and equipment	(484)	(857)	(455)
Acquisition of GMI, net of cash acquired	-	-	(32,875)
Net cash used in investing activities	(5,484)	(857)	(23,972)
Cash flows from financing activities:			
Proceeds from sale of treasury shares	-	-	9,595
Proceeds from exercise of options granted to employees	-	215	570
Net cash provided by financing activities	-	215	10,165
Decrease in cash and cash equivalents	(6,991)	(3,548)	(5,574)
Cash and cash equivalents at the beginning of the year	13,105	16,653	22,227
Cash and cash equivalents at the end of the year	\$6,114	\$13,105	\$16,653
Supplemental disclosure of cash flow information:			
Cash paid during the year for income taxes	\$66	\$582	\$460

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

Consolidated

Statements of Cash Flows

	U.S. dollars in thousands Year ended December 31,
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

(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. 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.

Notes

to Consolidated Financial Statements

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

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 and 2009 those assets were determined to be impaired (see Note 2h and Note 2i).

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.

Notes

to Consolidated Financial Statements

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, 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
Pro forma revenues	\$65,131
Pro forma net income	\$1,090
Pro forma basic earnings per share	\$0.21
Pro forma diluted earnings per share	\$0.20

(2) General

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

In June 2009, the FASB issued what has been codified in ASC 105 "Generally Accepted Accounting Principles" (formerly: SFAS No. 168, the FASB accounting standards codifications and hierarchy of GAAP - a replacement of SFAS 162). The Financial Accounting Standards Board (FASB) Accounting Standards Codification™ (Codification) became the single source of authoritative US GAAP. The Codification did not create any new GAAP standards but incorporated existing accounting and reporting standards into a new topical structure with a new referencing system to identify authoritative accounting standards, replacing the prior references to Statement of Financial Accounting Standards (SFAS),

Emerging Issues Task Force (EITF), FASB Staff Position (FSP), etc. Authoritative standards included in the Codification are designated by their Accounting Standards Codification (ASC) topical reference, and new standards will be designated as Accounting Standards Updates (ASU), with a year and assigned sequence number. The adoption of the Codification did not have a material impact on the Company's consolidated financial statements and notes thereto. The Company has appropriately updated its disclosures with the appropriate Codification references for the year ended December 31, 2009. As such, all the notes to the consolidated financial statements have been updated with the appropriate Codification references.

a. Use of estimates:

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and

Notes

to Consolidated Financial Statements

accompanying notes. The Company's management believes that the estimates, judgment and assumptions used are reasonable based upon information available at the time they are made. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A majority of the revenues of the Company are generated in U.S. dollars ("dollars"). In addition, a substantial portion of the Company's costs is incurred in dollars. Since management believes that the dollar is the currency of the primary economic environment in which the Company operate, the dollar is its functional and reporting currency. Accordingly, amounts in currencies other than U.S dollars have been remeasured in accordance with ASC 830 (Formerly known as 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. Intercompany balances and transactions including profits from intercompany sales not yet realized outside the Company, have been eliminated upon consolidation.

d. Reclassification:

Certain amounts for prior years have been reclassified to conform to the current year presentation.

e. Cash equivalents:

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

f. Short-term deposits:

A short-term bank deposit is a deposit with a maturity of more than three months but less than one year. The deposits are mainly in U.S. dollars and bear interest at rates ranging between 0.61% and 1.45%.

g. 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. For all year presented the write-offs 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.

Notes

to Consolidated Financial Statements

Spare parts for customer support - according to the "average cost method".

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.

h. 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 equipmen	6 - 20 (mainly 6)
Leasehold improvements	The shorter of the term of the lease or the useful life of the asset

i. 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.

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

The Company's long-lived assets and intangible assets subject to amortization are reviewed for impairment in accordance with ASC 360 (Formerly known as SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"), 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

Notes

to Consolidated Financial Statements

to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. During 2007, no impairment losses have been identified.

The Company performed an impairment test as of December 31, 2008 and 2009 since indicators of impairment were present. Following the tests, the Company recorded during 2008 and 2009 an impairment of the technology, Customer Relationships and Trademarks related to the acquisition of GMI (see Note 1b) in the amount of \$ 4,585 and \$ 2,491, respectively.

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.

k. Goodwill:

Goodwill represents the excess of the purchase price in a business combination over the fair value of the net assets acquired. Under ASC 350 (Formerly known as 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. ASC 350 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, and 2009 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 ASC 350. The Company performed its annual impairment test as of December 31, 2008 and 2009. Since

Notes

to Consolidated Financial Statements

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 during 2008 and 2009 an impairment of goodwill related to the acquisition of GMI (see Note 1b) in the amount of \$16,367 and \$2,045, respectively. In addition, the Company recorded in 2008 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.

l. Research and development costs:

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

m. Revenue recognition:

The Company derive its revenues from selling its 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 ASC 605, "Revenue Recognition" and 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 ASC 605-25 (Formerly known as ("EITF") Issue No. 00-21), "Revenue Arrangements with Multiple Deliverables" ("ASC 605-25"), 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.

Notes

to Consolidated Financial Statements

n. 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:

	2009	2008
Balance, beginning of year	\$646	\$889
Warranties utilized and expired during the year	(646)	(889)
Warranties issued during the year	538	646
Balance, end of year	\$538	\$646

o. 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, short-term deposits 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.

Generally cash and cash equivalents and short term deposits may be redeemed on demand and therefore minimal credit risk exists with respect to these investments.

The Company's trade receivables are derived from sales to customers located primarily in the United States and Europe. The Company performs ongoing credit evaluations of its customers and to date has not experienced any material losses. In certain circumstances, the Company may require letters of credit or other collateral. An allowance for doubtful

accounts is determined with respect to those amounts that the Company has determined to be doubtful of collection.

As of December 31, 2009 and 2008, the allowance for doubtful accounts amounted to \$ 710 and \$ 695, respectively. Bad debt expense amounted to \$ 513, \$ 510 and \$ 56 in 2009, 2008 and 2007, 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.

p. Stock-based compensation:

The Company accounts for stock-based compensation in accordance with ASC 718 Compensation - Stock Compensation (formerly SFAS No. 123(R)). ASC 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's

Notes

to Consolidated Financial Statements

consolidated statements of operations.

The Company recognizes compensation expenses for the value of its awards granted based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

The Company selected the Monte Carlo simulation option pricing model as the most appropriate fair value method for its equity-based awards and values options based on the market value of the underlying shares on the date of grant. The option-pricing model

requires a number of assumptions, of which the most significant are the expected stock price volatility and the expected term of the equity-based award. Expected volatility is calculated based upon actual historical stock price movements. The expected term of the equity-based award granted is based upon historical experience and represents the period of time that the award granted is expected to be outstanding. The risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

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, 2007		
	2009	2008	2007
Risk-free interest rate	1.49%	1.88%	4.53%
Suboptimal exercise multiple	3	3	3
Forfeiture rate	10.00%	7.11%	8.44%
Dividend yield	-	-	-
Expected volatility	70 %	56 %	39 %

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.

q. Comprehensive income

The Company accounts for comprehensive income in accordance with ASC 220 (Formerly known as SFAS No. 130, "Reporting Comprehensive Income"). This statement establishes standards for the reporting and display of comprehensive income and its components in

Notes

to Consolidated Financial Statements

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.

r. 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 charges the excess of the purchase cost over the re-issuance price (loss) to retained earnings, net from the accumulated stock based compensation. 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.

s. 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 \$ 848, \$ 842 and \$ 403 in 2009, 2008 and 2007, respectively. Total royalties accrued or paid amounted to \$ 739, \$ 1,041 and \$ 1,126

in 2009, 2008 and 2007, respectively and were recorded in the cost of revenues.

t. Fair value of Financial instruments:

Cash and cash equivalents, short-term deposits, marketable securities, trade receivables, trade payables and accrued liabilities are measured at fair values.

Fair value is an exit price, representing the amount that would be received for selling 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, ASC 820 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.

u. Severance pay:

The Company's liability for its Israeli employee's severance pay is calculated pursuant to the Israeli

Notes

to Consolidated Financial Statements

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 expenses for the years ended December 31, 2009, 2008 and 2007 amounted to \$ 438, \$ 641 and \$ 660, respectively.

v. 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. The diluted net earnings per share for the year ended December 31, 2007 are computed based on the weighted average number of Ordinary shares outstanding during each year plus dilutive potential equivalent Ordinary shares considered outstanding during the year, in accordance with ASC 260, "Earnings Per Share" (formerly SFAS No. 128). For the years ended December 31, 2008 and 2009, all outstanding options to purchase shares were excluded from the calculation of diluted loss per share because their effect on the loss per share is anti-dilutive.

w. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with ASC 740 (Formerly known as SFAS No. 109, "Accounting for Income Taxes"). 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.

ASC 740 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with ASC 740. 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 the adoption of this accounting guidance that became effective at January 1, 2007, we recognized a charge of approximately \$ 622 to the January 1, 2007 retained earnings balance. The

Notes

to Consolidated Financial Statements

Company accrues interest and penalties related to unrecognized tax benefits as tax expenses.

x. Impact of recently issued accounting pronouncements:

In October 2009, the FASB issued an update to ASC 985-605, "Software-Revenue Recognition" (originally issued as EITF 09-3). In accordance with the update to the ASC, tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality are excluded from the scope of the software revenue recognition guidance. In addition, hardware components of a tangible product containing software component are always excluded from the software revenue guidance. The mandatory adoption is on January 1, 2011. The Company may elect to adopt the update prospectively, to new or materially modified arrangements beginning on the adoption date, or retrospectively, for all periods presented. The Company is currently evaluating the impact on its consolidated results of operations and financial condition. In October 2009, the FASB issued an update to ASC 605-25, "Revenue recognition - Multiple-Element Arrangements", that provides amendments to the criteria for separating consideration in multiple-deliverable arrangements to:

Provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;
Require an entity to allocate revenue in an arrangement using estimated selling prices ("ESP") of deliverables if a vendor does not have vendor-specific objective evidence of selling price ("VSOE") or third-party evidence of selling

price ("TPE"); and Eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

Require expanded disclosures of qualitative and quantitative information regarding application of the multiple-deliverable revenue arrangement guidance.

The Company may elect to adopt the update prospectively, to new or materially modified arrangements beginning on the adoption date, or retrospectively, for all periods presented. The Company is currently evaluating the impact on its consolidated results of operations and financial condition.

In May 2009, FASB issued ASC Topic No. 855 "Subsequent Events" ("FASB ASC No. 855"). FASB ASC No. 855 is intended to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, FASB ASC No. 855 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. FASB ASC No. 855 was effective for fiscal years and interim periods ended after June 15, 2009. The adoption did not have a material effect on the Company's consolidated financial statements.

Notes

to Consolidated Financial Statements

(3) Other Accounts Receivable and Prepaid Expenses

	Year ended December 31,	
	2009	2008
Government grants	\$187	\$580
Government authorities	1,863	1,635
Prepaid expenses	415	955
Other accounts receivable	173	72
	\$2,638	\$3,242

(4) Inventories

	Year ended December 31,	
	2009	2008
Raw materials	\$2,563	\$3,246
Work in progress	968	344
Finished products	1,134	2,442
Spare parts for customer support	1,352	1,101
	\$6,017	\$7,133

(5) Property and Equipment

	Year ended December 31,	
	2009	2008
Cost:		
Computers and peripheral equipment	\$2,603	\$2,441
Machinery and equipment	1,587	1,348
Office furniture and equipment	571	515
Leasehold improvements	401	374
	5,162	4,678
Accumulated depreciation:		
Computers and peripheral equipment	2,202	1,758
Machinery and equipment	860	575
Office furniture and equipment	217	130
Leasehold improvements	132	125
	3,411	2,588
Property and equipment, net	\$1,751	\$2,090

Notes

to Consolidated Financial Statements

Depreciation expense for the years ended December 31, 2009, 2008 and 2007 was \$823, \$ 840 and \$457, 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,	
	2009	2008
Goodwill, beginning of year	\$2,045	\$19,237
Impairment	(2,045)	(17,192)
Goodwill, end of year	\$-	\$2,045

b. Intangible assets, net

	December 31,	
	2009	2008
Cost:		
Technology (1)	\$3,767	\$5,387
Customer Relationships (2)	670	1,405
Backlog	1,396	1,396
Trademarks (3)	298	434
	6,131	8,622
Accumulated amortization:		
Technology	2,548	1,950
Customer Relationships	349	71
Backlog	1,396	1,396
Trademarks	98	54
	4,391	3,471
Intangible assets, net	\$1,740	\$5,151

Notes

to Consolidated Financial Statements

Net of impairments of \$ 4,585 and \$ 6,205 on December 31, 2008 and 2009, respectively (see Note 2h,i).

Net of an impairment of \$ 735 on December 31, 2009 (see Note 2h,i).

Net of an impairment of \$ 136 on December 31, 2009 (see Note 2h,i).

Amortization expenses amounted to \$ 919, \$ 2,172 and \$ 1,093 for the years ended December 31, 2009, 2008 and 2007, respectively.

Estimated amortization expenses for the years ended:

Year	December 31,
2010	298
2011	374
2012	363
2013	339
2014	366
	1,740

(7) Accrued Expenses and Other Liabilities

	December 31,	
	2009	2008
Provision for warranty costs	\$538	\$646
Government authorities and tax provision	2,255	2,384
Accrued expenses and other liabilities	1,662	1,751
	\$4,455	\$4,781

(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.

Future minimum lease commitments under non-cancelable operating leases as of December 31, 2009, are as follows:

Notes

to Consolidated Financial Statements

Year	Lease commitment
2010	1,787
2011	1,643
2012	1,527
2013	1,310
2014 and thereafter	1,669
	7,936

Total rent expenses for the years ended December 31, 2009, 2008 and 2007 amounted to \$ 1,639, \$ 2,294 and \$ 1,443, 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, 2009, the Company has a contingent obligation to pay royalties in respect of the aforementioned grants in the approximate amount of \$ 2,078.

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, 2009, 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 29% in 2007, 27% in 2008, 26% in 2009, 25% in 2010, 24% in 2011, 23% in 2012, 22% in 2013, 21% in 2014, 20% in 2015, 18% in 2016 and thereafter.

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

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

In accordance with the Law, the Company

Notes

to Consolidated Financial Statements

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.

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 thereunder and the certificates of approval for the specific investments in "Approved Enterprises".

Should the Company fail to meet such requirements in the future, income attributable to its "Approved Enterprise" or "Privileged Enterprise" programs could be subject to the statutory Israeli corporate tax rate, and the Company could be required to refund the tax benefits already received with respect to such program, in whole or in part, including interest.

In the event of distribution of dividend from the above mentioned tax-exempt income, the amount distributed will be subject to corporate tax at the rate ordinarily applicable to the Approved Enterprise's and Privileged Enterprise's income.

Out of the Company's earnings available for distribution as of December 31, 2009, \$ 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,

Notes

to Consolidated Financial Statements

2009. 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, 2009, the Company had approximately \$ 4,600 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, 2009, the U.S. subsidiary had U.S. federal carryforward tax losses of approximately \$ 4,100 that can be carried forward and offset against taxable income for 12-20 years and expire from 2021-2029. As of December 31, 2009, the German subsidiary had carryforward tax losses of approximately

\$ 820, which may be carried forward and offset against taxable income in the future for an indefinite period.

d. Final tax assessments

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

e. Deferred income taxes:

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. As of December 31, 2009, 2008 and 2007, the Company's deferred taxes were in respect of the following:

Notes

to Consolidated Financial Statements

	December 31,		
	2009	2008	2007
Deferred tax assets:			
Operating losses carryforwards	\$2,580	\$2,463	\$1,984
Intangibles assets	2,204	1,565	-
Reserves and allowances not currently deductible	2,025	3,023	2,465
Total deferred tax asset	6,809	7,051	4,449
Deferred tax liability:			
Intangibles assets	-	-	(1,141)
Property and equipment	(93)	(141)	(87)
Total deferred tax liability	(93)	(141)	(1,228)
Net deferred tax asset before valuation allowance	6,716	6,910	3,221
Valuation allowance	(6,716)	(5,250)	(1,561)
Net deferred tax asset	\$-	\$1,660	\$1,660
Domestic:			
Current deferred tax asset	773	1,303	555
Non-current deferred tax asset	719	479	477
Valuation allowance	(1,492)	(122)	-
	-	1,660	1,032
Foreign:			
Current deferred tax asset	963	1,447	1,636
Non-current deferred tax asset	4,354	3,822	1,781
Non-current deferred tax liability	(93)	(141)	(1,228)
Valuation allowance	(5,224)	(5,128)	(1,561)
	-	-	628
	\$-	\$1,660	\$1,660

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

	YEAR ENDED DECEMBER 31,		
	2009	2008	2007
DOMESTIC	\$(3,030)	\$(2,617)	\$9,053
FOREIGN	(5,949)	(22,505)	(5,301)
	\$(8,979)	\$(25,122)	\$3,752

Notes

to Consolidated Financial Statements

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

	Year ended December 31,		
	2009	2008	2007
Current	\$67	\$29	\$689
Deferred	1,660	-	(1,752)
	1,727	29	(1,063)
Domestic	1,660	(342)	(306)
Foreign	67	371	(757)
	1,727	29	(1,063)
Domestic:			
Current	-	286	389
Deferred	1,660	(628)	(695)
	1,660	(342)	(306)
Foreign:			
Current	67	(257)	(129)
Deferred	-	628	(628)
	\$67	\$371	\$(757)

h. Reconciliation of the theoretical tax expense:

	Year ended December 31,		
	2009	2008	2007
Income (loss) before taxes on income	\$(8,979)	\$(25,122)	\$3,752
Statutory tax rate	26%	27%	29%
Theoretical tax at statutory tax rate	\$(2,335)	\$(6,783)	\$1,088
Increase (decrease) in respect of:			
Losses, reserves and allowances for which valuation allowance was provided	1,101	686	824
Utilization of carryforward losses for which valuation allowance was provided in prior years	-	(159)	(303)
Tax adjustment in respect of "Approved Enterprise" status	-	(371)	(3,268)
Tax adjustment in respect of foreign subsidiaries different tax rates	(804)	(2,768)	197
Stock-based compensation expense	205	265	213
Non-deductible expenses	162	618	186
Impairment of Goodwill and Intangible assets	1,769	8,171	-
Valuation allowance for previously recognized deferred tax asset	1,660	629	-
Other	(31)	(259)	-
Actual tax expense (benefit)	\$1,727	\$29	\$(1,063)

Notes

to Consolidated Financial Statements

i. The Company file income tax returns in Israel, United States and various foreign jurisdictions. Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation ASC 740 (Formerly known as SFAS No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" ("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 recognized \$86 and \$ 285, for the years ended December 31, 2009 and 2008, respectively, 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:

	December 31,	
	2009	2008
Beginning balance	\$1,895	\$2,169
Additions for tax positions of prior yea	86	285
Reductions for tax positions of prior year	(86)	(559)
Ending balance	\$1,895	\$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.

Notes

to Consolidated 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, 2009 and 2008, the Company is holding 976,549 and 990,103 treasury shares, respectively.

c. Stock option plans:

Under the 2003 Stock Option Plan, the Company is authorized to grant options to purchase Ordinary shares to its Israeli employees, non-employees directors and

non-employees consultants. Under the 1999 U.S. Option Plan and the Global Plan, the Company is authorized to grant stock options to non-Israeli employees, officers and non-employees consultants. 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, 2009, 178,168 options are available for future grants.

Notes

to Consolidated Financial Statements

A summary of the stock option activities in 2009 is as follows:

	Amount	Wighted average exercise price	Wighted average remaining contractual life	Aggregate Intrinsic value
Outstanding at January 1, 2007	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
Granted	202,500	2.78		
Exercised	(13,554)	0.00		
Forfeited	(53,584)	5.97		
Outstanding at December 31, 2009	582,317	4.34	5.43	*) 709
Vested and expected to vest at December 31, 2009	491,895	4.50	5.39	***) 410
Exercisable at December 31, 2009	224,875	5.43	4.66	***) 174

*) Represents intrinsic value of 365,542 outstanding options that are in-the-money as of December 31, 2009. The remaining 216,775 outstanding options are out of the money as of December 31, 2009 and their intrinsic value was considered as zero.

***) Represents intrinsic value of 226,836 vested and expected to vest options that are in-the-money as of December 31, 2009. The remaining 265,059 vested and expected to vest options are out of the money as of December 31, 2009 and their intrinsic value was considered as zero.

***) Represents intrinsic value of 59,850 exercisable options that are in-the-money as of December 31, 2009. The remaining 165,025 exercisable options are out of the money as of December 31, 2009 and their intrinsic value was considered as zero.

Notes

to Consolidated Financial Statements

As of December 31, 2009, \$ 912 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.18 years.

The weighted-average grant-date fair value of options granted during the years 2009, 2008 and 2007 was \$ 1.51, \$ 4.69, and \$ 7.16, respectively. The total intrinsic value of options exercised during the years ended December 31, 2009, 2008 and 2007, was \$ 54, \$ 326 and \$ 1,052, respectively.

Following are the outstanding options by exercise price as of December 31, 2009:

Exercise price	Outstanding			Exercisable		
	Number exercisable	Wighted average remaining contractual life (years)	Wighted average exercise price	Number exercisable	Wighted average remaining contractual life (years)	Wighted average exercise price
0	77,267	6.57	-	34,267	5.38	-
2.12-3.00	273,275	5.36	2.71	25,583	5.33	2.77
3.05-4.78	92,275	4.31	4.21	62,275	3.58	4.35
6.84-8.00	79,500	4.52	7.22	79,500	4.50	7.22
15.41-15.45	60,000	7.24	13.69	23,250	6.26	14.90
	582,317	5.43	4.34	224,875	4.66	5.43

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

	Year ended December 31,		
	2009	2008	2007
Cost of revenues	\$98	\$119	\$108
Research and development	124	128	123
Selling and marketing	218	240	174
General and administrative	299	452	326
Total stock-based compensation expense	\$739	\$939	\$731

Notes

to Consolidated Financial Statements

(11) Earnings Per Share

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

	Year ended December 31,		
	2009	2008	2007
Net income (loss)	\$(10,706)	\$(25,151)	\$4,815
Weighted average Ordinary shares outstanding - Basic EPS	5,310,677	5,290,919	5,092,696
Dilutive effect:			
Employee stock options	-	-	275,896
Weighted average Ordinary shares outstanding - Diluted EPS	5,310,677	5,290,919	5,368,592
Basic earnings (loss) per share	(2.02)	(4.75)	0.95
Diluted earnings (loss) per share	(2.02)	(4.75)	0.9

The total numbers of options excluded from the calculation of diluted net earnings per share, as they would have an anti-dilutive effect were 582,317, 446,955 and 204,660 for the years ended December 31, 2009, 2008 and 2007, 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 and in the U.S. include research and development, manufacturing, customer support, marketing and sales. Operations in Europe include customer support and sales.

Notes

to Consolidated Financial Statements

The following is a summary of operations within geographic areas:

	Year ended December 31,		
	2009	2008	2007
Revenues based on the customer's location:			
United States	\$17,686	\$25,215	\$18,414
Europe (other than Germany)	11,068	16,524	11,487
Germany	2,852	7,827	5,415
Other	5,625	10,754	4,568
	\$37,231	\$60,320	\$39,884

	December 31,	
	2009	2008
Long-lived assets by geographic location:		
Israel	\$985	\$1,085
Europ	1	34
United States	754	971
	\$1,751	\$2,090

(13) Selected Statements of Operations Data

Financial income (loss), net:

	Year ended December 31,		
	2009	2008	2007
Financial income:			
Interest	\$17	\$286	\$1,388
Dividend received on marketable securities	-	-	368
Foreign currency translation differences, net	104	-	1,305
	121	286	3,061
Financial expenses			
Bank charges	184	210	82
Realized loss on sale of marketable securities	-	-	135
Foreign currency translation differences, net	-	1,315	-
	184	1,525	217
	\$(63)	\$(1,239)	\$2,844

Report of the Board of Directors

Dear Shareholders,

During 2009 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, 2009, the Board of Directors consisted of 6 members, including 2 external Directors. Board meetings focused on the global economic crisis and its impact on AVT, on strategies for profitable growth through integration of technologies and products of GMI and AVT opening up cross market selling opportunities and on business development in emerging markets which have growth potential.

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.

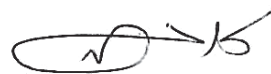
The committee is also responsible for the nomination of the company's Internal Auditor, the determination of his annual audit plan, review of his final reports, and the supervision

of his recommendations' implementation. During 2009, we held 5 Board of Directors meetings, 4 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, 2009 and 2008, and the related consolidated statements of income, changes in shareholders' equity and cash flow for each of the three years ended December 31, 2009, were audited by KOST FORER GABBAY & KASIERER, a member of Ernst & Young Global.

In the Audit Committee meeting held on February 15, 2010 and Board of Directors meetings held on February 17, 2010 and March 25, 2010, attended by the company's auditors and legal counsel, we discussed the 2009 Financial Statements and resolved to approve the Annual Report. We have further resolved to present the Financial Statements for review and discussion at the Annual General Meeting of Shareholders.

Hod Hasharon, March 25, 2010



Yeoshua Agassi
Chairman

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 Israel's largest investment and holding companies in Israel. During 2000, Mr. Agassi served as General Manager of Leumicard Ltd., one of Israel's 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.

Members

of the Board of Directors

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.

WWW.avt-inc.com

AVT LTD.
6 Hanagar St.
P.O.B 7295, Hod-Hasharon 45241,
Israel
Tel. +972 9 761 4444
Fax. +972 9 761 4555

AVT INC.
900 Circle 75 Parkway
Suite 175, Atlanta, GA 30339,
USA
Tel. +1 770 541 9780
Fax. +1 770 541 9342

AVT GmbH
Donnersbergerstrasse 22a
80634 Munich
Germany
Tel. +49 89 216 68 079
Fax. +49 89 216 68166

GMI Inc.
1655 Science Place
Rockwall, TX 75032,
USA
Tel. +1 972 290 3200
Fax. +1 972 722 1128

AVT EMEA
Mechelsesteenweg 132
B-2860 Sint-Katelijne-Waver
Belgium
Tel. +32 (0) 15 56 03 80
Fax. +32 (0) 15 55 39 97

AVT China
AVT Ltd Shanghai Representative Office
Room 808B,
Building 555, No. 555 Nanjing Xilu
Shanghai 200041,
China
Tel. +86 21 6258 2367
Fax. +86 21 62582359

AVT and PrintVision are trademarks owned by AVT Ltd. AVT reserves the right to make changes to the specifications without prior notification.

