The Printer's Choice | AVT.

Advanced Vision Technology (A.V.T.) Ltd.

2014 Annual Report January 1st - December 31st

Financial Highlights

US dollars in thousands, except share and per share amounts			
Year ended December 31,	**2014**	**2013**	**2012**
Revenues and Income			
Revenues	54,110	50,498	48,014
Gross profit	28,291	27,128	25,611
Gross margin in %	52.3%	53.7%	53.3%
Research and development expenses, net	7,655	7,287	6,498
Selling and marketing expenses	9,605	8,983	9,113
General and administration expenses	5,083	5,092	4,706
Operating income	5,948	5,766	5,294
Operating margin in %	11.0%	11.4%	11.0%
Net income	4,625	6,584	4,905
Cash Flows			
Cash flows provided by operating activities	5,229	8,625	5,388
Cash flows provided by (used in) investing activities	2,503	(7,898)	527
Cash flows provided by (used in) financing activities	(5,062)	(1,023)	337
Balance sheet as of December 31,			
Cash and equivalents	26,216	26,630	19,346
Total assets	50,629	50,978	41,329
Total liabilities	17,711	17,875	14,024
Total shareholders' equity	32,918	33,103	27,305
Share			
Basic earnings (loss) per share in US dollars	0.77	1.16	0.91
Share price as of December 31,	9.10 Euro	7.8 Euro	5.40 Euro
Employees			
Employees as of December 31,	217	198	194

Dear Shareholder,

2014 was a good year for AVT, with continued improvement in our business resulting in growth of both revenues and order bookings with slightly higher operating income. Over the year, AVT saw increased revenues from its labels and packaging offerings, in both product and service sales. Revenues in 2014 totaled $54.1 million, an increase of 7.2% compared with revenues of $50.5 million in 2013. Operating income totaled $5.9 million, an increase of 3.2% compared with the operating income of $5.8 million in 2013. Net income totaled $4.6 million, a decrease of 30.0% compared with $6.6 million in 2013 (net income in 2013 was positively impacted by one-time tax benefits which did not repeat in 2014). Total order bookings for the year were $52.9 million.

During 2014, we implemented our operational plan, in which we increased investments in R&D, sales, marketing and customer support in order to build the necessary foundation for the accelerated growth for which we are striving. As part of the aforementioned plan, we announced recruitment of new AVT management team members including the CFO, COO, VP Marketing, VP Human Resources and Business Processes, and new Presidents for both Europe and the Americas. I believe that these new players together with our veteran strong CBO, VP R&D and VP Business Development form a strong management team that can lead AVT to significant successes in the years to come.

During the past year, we executed several key product launches for our packaging and label applications serving to support our growth. In September, we launched the new packaging Turbo product series, offering high resolution inspection on high speed presses, to differentiate AVT from competition and strengthen our competitive position. In September we also launched our new Helios S and Workflow product family at Label Expo Americas. The Helios S was designed to support special effects and label applications for the food, spirit and other industries, while the workflow products offer our customers unprecedented levels of production workflow management and reporting.

In September 2014 At Label Expo Americas in Chicago, we also launched our new AVT branding initiative – including an entirely revamped website – complete with a new tagline: "The Printer's Choice," to reflect our further focus on customer experience while remaining the premier overall solutions provider. During that same event, we showcased twelve of our systems in total -in the official AVT booth and integrated with partners' systems in their booths. This reflected our continuously growing, strong partner/OEM network and coverage, reinforcing our new credo of "The Printer's Choice."

In the closing months of 2014, we saw increasing demand for our Titan inspection solution for metal decoration applications. Subsequently we expect new installations with key customers to drive growth in this new application in 2015.

2014 was a landmark year for AVT in the digital arena, as we became the first to offer advanced dedicated press control solutions for the growing digital inkjet industry. In October, we showcased our Digital Press Control Solution with Gallus-Heidelberg at the Gallus' Innovations Days customer event, and announced that Landa Digital Printing had chosen AVT as its strategic provider for print quality and control solutions for their presses. We continued to enhance our digital presence by installing AVT's Apollo 20K systems integrated with the Zeroset workflow module on new HP/Indigo 20000 flexible packaging presses at several customer sites. The resulting positive customer feedback and performance satisfaction is leading to additional opportunities. These newly announced partnerships, together with our expanding alliance with HP, position AVT as the leading provider of quality and inspection solutions for digital printing of labels and packaging.

I want to take this opportunity to thank our shareholders for their continued support.
I look forward to working together with our great team at AVT towards further increase of shareholder value.

Sincerely yours,

Jaron Lotan, President & CEO

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

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

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

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

Our Solutions

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

Solution	Customer Need	Purpose
Jupiter	Packaging - on press Process Control	The industry standard solution for on-press automatic inspection. The Jupiter offers superior Process Control capabilities that reduces production cost and enhances product quality. The Jupiter can be equipped with added value modules such as press control, color management and barcode verification.
Apollo	Packaging - 100% Quality Assurance	Equipped with 100% LCCD technology, the Apollo offers Quality Assurance solution and can be integrated on press or on various post press stages such as Lamination, Doctoring or slitting rewinding.
Helios II / Helios S	Labels and narrow web printing inspection applications	Advanced 100% automatic inspection platform that support the specific label & narrow web application & workflows. Installed on press or on rewinder, the Helios series provides excellent Process Control & 100% Quality Assurance.
Argus Turbo / Argus E Turbo	Packaging - on press Process Control & Quality Assurance	A unique combination of Process Control & Quality Assurance. Argus series is the top of the line solution for high quality packaging applications. The new Argus/Argus E Turbo offers a unique, leading high

		resolution and high-speed 100% inspection with in image register and pressure setting / press control.
pRegister and iReg	Packaging	pRegister is an automatic register pre-setting and control module. The iReg module adds simplicity of click and drag to the register process and does not require any special targets to bring the press to registration.
Presco	Packaging	Automatic plate pressure pre-setting and control module
IΔEal	Packaging	In line color monitoring module for ΔE and ΔL*a*b-based color pre-setting guidance and run-time color management
SpectraLab	Packaging	The latest in absolute color measurement technology deployed for packaging and label applications. An inline color measurement solution that measures and reports spectral L*a*b* values.
WorkFlow Link II	Label & Packaging	The industry standard for end-to-end Quality Control solution, WFL II enables digital, automatic handling of defected material removal at the finishing stage, based on the AVT inspection information gathered along the production workflow
PrintFlow II product family	Data Management	PrintFlow II product family enables comprehensive management of print quality information. It includes: • PrintFlow II – an SQL database that collects online all Quality data • PrintFlow Central – enables multi-systems and multi-site data storage • PrintFlow Manager II – enables sophisticated reporting, statistics and QA management
ZeroSet	HP® web presses - Label & Packaging	An automation solution for HP ® digital web presses that are powered by an Esko® DFE (Digital Front End). AVT ZeroSet offers an automated inspection setup, job audit, print defect detection and process control.
Titan	Packaging/ Metal Decorated Boxes	AVT's 100% automatic inspection platform that supports the specific needs of metal sheet printers for metal boxes . Installed on metal sheet printing press and provides excellent Process and Quality assurance.
Mercury	Web and sheet-fed offset presses (Commercial, Newspaper, Packaging, Labels)	A remote ink control solution, that offers powerful HW & SW platforms, ease-of-use touch screens and a new Level of automation,
Clarios	Commercial and Newspaper printing/ Web Offset	Closed loop color control system that utilizes a spectrophotometer to measure colors on press. The Clarios system converts spectrophotometric data to industry standard ink density and L*a*b* 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. The system reduces production cost while improving print quality
SnapReg	Commercial printing/ Web Offset	State of the art automatic closed loop color-to-color register control designed for commercial presses. SnapReg is an add-one module to Clarios & Mercury platforms

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, 2014 more than 7,000 AVT systems are installed at customer sites worldwide. No distributor or end-user accounted for more than 10% of revenues in 2014 or 2013

Overview

AVT was incorporated in Israel in October 1992 and introduced the prototype of its first product, the PrintVision/ 9000, in 1995. 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 19, 2002 we concluded the acquisition of the assets of Geiger Vision Systems GmbH (GVS) of Munich, Germany for a consideration of approximately 1 (one) million Euro. The acquisition of GVS assets (mostly intangible) was a strategic decision to facilitate the penetration into label inspection applications. 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.

AVT (Germany) GmbH was established in June 2002 to absorb the assets and operations of GVS and became our selling arm in the German speaking countries in Europe. As of January 1, 2006 AVT (Germany) GmbH commenced serving as our direct distribution channel for Europe. AVT EMEA (Belgium) CVBA 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.

Via this acquisition AVT expanded its offerings to commercial and newspaper printing.

GMI's products are sold to leading commercial, semi-commercial, newspaper and specialty printers in the heatset and coldset web printing 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 offerings to the printing industry both in terms of applications and process and color control solutions offered to the traditional customer base of both AVT and GMI. The factors that contributed to the purchase price that resulted in recognition of goodwill included synergies, the benefits of increased volume and strategic positioning value.
Our future revenues and operating results may fluctuate on a quarterly basis 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 2014 the European currency decreased in value relative to the US Dollar by approximately 11.8%. In Israel, during 2014, the New Israel Shekel ("NIS") decreased in value relative to the US Dollar by 12.0%.

Off-Balance Sheet Transactions

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

- **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 label inspection products in our facility in Hod Hasharon, Israel. Our commercial printing products as well as our Closed Loop Color Control solutions and absolute color measurement solutions for packaging and labels are manufactured in our facility in Texas, USA. Our products are built in accordance with industry standard infrastructure and are PC compatible. The hardware elements in our packaging and label inspection products are based primarily on standard commercial off-the-shelf components. The hardware elements for our commercial printing as well as absolute color measurement solutions for packaging and label inspection are manufactured mainly in the Texas 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 work directly with some of the more significant manufacturers of our components. Although certain of the 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 Texas, that offer support to our customers and distributors. These service engineers, as well as additional service engineers located in our subsidiaries in Europe in the Americas and in Asia-Pacific, provide first class field services and support worldwide. We install, service and provide training to customers on all our products. Installation of a typical system can usually be completed at the customer's site, either by us or by third parties, within a very short time after delivery and with a minimum amount of site preparation by the customer. Generally, our customer support engineer installs and checks the system. As part of the installation procedure, we provide system documentation and basic training in maintenance and application.

We maintain regular training and installation support sessions for our service engineers and distributors. Our systems are generally sold with a warranty for repairs of hardware and software defects and malfunctions. The usual term of such warranty is one year after installation. In addition, for a fee, we offer customers service and maintenance contracts commencing after the expiration of the warranty period. Software, whether contained in optional features or forming an integral part of the functioning capacity of the system, is licensed. Software updates are typically included in the service fee.

- **Research & Development**

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

- **Selling and Marketing**

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 and indirectly through our representative office in China as well as through a network of dealers and representatives in Asia-Pacific.

Approximately 39 people are engaged in the Company's worldwide selling and marketing efforts, which include participation in various trade shows and conventions, publications and trade press, demonstrations performed in Company facilities and daily contact with customers by sales personnel.

Critical Accounting Policies

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

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

- Revenue Recognition
- Inventory Valuation
- Impairment of Long-Lived Assets and Goodwill
- Taxes on Income
- Stock-Based Compensation
- Impact of Inflation and Exchange risk

Revenue recognition. We derive revenues primarily from two sources: product revenues, which include hardware and software; and service revenues, which are comprised mainly of income from hardware and software maintenance contracts; time and material charges; consulting, installation and training fees and sales of spare parts. Revenues related to the sale of our products are 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 on 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.

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

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

Impairment of Long-Lived Assets, other intangible 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. No impairment charge has arisen as a result of the impairment evaluations performed in the fourth quarters of 2014, 2013 and 2012.

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.

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 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 an impairment test should circumstances indicate that an impairment loss may exist. The outcome of such testing may lead to the recognition of additional impairments. During 2014, 2013 and 2012 no indicators for such impairment existed.

As of December 31, 2014, the carrying value of our long-lived asset was $113 thousand including Technology & Patents, Customer Relationships and Trademarks/Trade names related to GMI acquisition.

ASC 360 requires us to assess the impairment of long-lived assets, tangible and intangible, other than goodwill, 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.

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. 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, dividend yield 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. 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 with the remainder primarily incurred in New Israel Shekel ("Shekel" or "NIS") and Euro. Since the US Dollar is the primary currency in the economic environment in which the Company operates, the US Dollar is its functional currency and accordingly, monetary accounts maintained in currencies 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.

The NIS has revalued in relation to the US Dollar and other major currencies during 2012 and 2013 and has devalued in relation to the US Dollar during 2014. Such devaluations and revaluations in any particular fiscal period are never completely synchronized with the rate of inflation. The following table summarizes the annual rate of devaluation and revaluation of the NIS against the US Dollar and the gap between these and the rate of inflation in Israel

	Year Ended December 31,		
	2014	2013	2012
Inflation	(0.2)%	1.8%	1.6%
Devaluation (Revaluation)	12.0%	(7.0%)	(2.3%)
Inflation (devaluation) gap	(12.2%)	8.8%	3.9%

Although a material portion of our costs relate to 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 of 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%

Operating Results

The following table sets forth selected consolidated statements of income data for each of the years ended December 31, 2014, 2013 and 2012 in thousands US Dollars:

	Year Ended December 31,		
	2014	2013	2012
Revenues	54,110	50,498	48,014
Cost of revenues	25,819	23,370	22,403
Gross profit	28,291	27,128	25,611
Gross margin in %	52.3%	53.7%	53.3%
Operating expenses:			
Research and development, net	7,655	7,287	6,498
Selling and marketing	9,605	8,983	9,113
General and administrative	5,083	5,092	4,706
Total operating expenses	22,343	21,362	20,317
Operating income	5,948	5,766	5,294
Financial Income (expense), net	28	(64)	(31)
Income before taxes on income	5,976	5,702	5,263
Taxes on income (tax benefit)	1,351	(882)	358
Net income	4,625	6,584	4,905

The following table sets forth selected consolidated statements of income data for each of the three years ended December 31, 2014, 2013 and 2012 expressed as a percentage of total revenues:

	Year Ended December 31,		
	2014	2013	2012
Revenues	100%	100%	100%
Cost of revenues	47.7	46.3	46.7
Gross profit	52.3	53.7	53.3
Operating expenses:			
Research and development, gross	14.1	14.7	14.9
Less - grants	-	(0.3)	(1.4)
Selling and marketing	17.8	17.8	19.0
General and administrative	9.4	10.1	9.8
Total operating expenses	41.3	42.3	42.3

Operating income	11.0	11.4	11.0
Financial Income (expense), net	-	(0.1)	(0.1)
Income before taxes on income	11.0	11.3	10.9
Taxes on income (tax benefit)	2.5	(1.7)	0.7
Net income	8.5	13.0	10.2

The annual schedule of amortization of acquired intangible assets is comprised of amortization of Technology in the amount of $191 thousand in 2014 and $257 thousand in each of the years 2013 and 2012, and of Customer Relationships and Trade Marks amortization in the amounts of $63 thousand, $82 thousand and $106 thousand, in 2014, 2013 and 2012 respectively.
Technology and Trade Marks are amortized ratably over 7 and 10 years, respectively and Customer Relationships are amortized using the accretion method over 10 years commencing from the date of closing on October 1, 2007.

The following table sets forth selected proforma consolidated statements of income data for each of the years ended December 31 2014, 2013 and 2012 in thousands US Dollars, adjusted to exclude the impact of non-cash annual amortization of acquired intangible assets of $254 thousand in 2014, $339 thousand in 2013 and $363 thousand in 2012 (proforma consolidated statements of income also excludes non cash stock-based compensation expenses of $252 thousand in 2014, $237 thousand in 2013 and $271 thousand in 2012):

	Year Ended December 31,				
	2014			2013	2012
	GAAP	Adjustments	Non GAAP	Non GAAP	Non GAAP
Revenues	54,110	-	54,110	50,498	48,014
Cost of revenues	25,819	220	25,599	23,069	22,093
Gross profit	28,291	220	28,511	27,429	25,921
Gross margin in %	52.3%		52.7%	54.3%	54.0%
Operating expenses:					
Research and development, net	7,655	60	7,595	7,227	6,430
Selling and marketing	9,605	102	9,503	8,828	8,918
General and administrative	5,083	124	4,959	5,032	4,645
Total operating expenses	22,343	286	22,057	21,087	19,993
Operating income	5,948	506	6,454	6,342	5,928
Financial Income (expense), net	28	-	28	(64)	(31)
Income before taxes on income	5,976	506	6,482	6,278	5,897
Taxes on income (tax benefit)	1,351	-	1,351	(882)	358
Net income	4,625	506	5,131	7,160	5,539

Year ended December 31, 2014, compared with year ended December 31, 2013

In fiscal 2014 we have seen continued improvement in our business. During the year we increased our revenues from labels and packaging inspection solutions, while also increasing our investments in several areas to drive future growth and we have managed to achieve sustainability in our profitability. We remain focused on achieving long term sustainable growth in our business and profitability.

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 2014 totaled $54.1 million, 7.2% higher than the $50.5 million generated in 2013.

Revenues in the fourth quarter of 2014 were $13.0 million, same as in Q4 2013.

The increase in total revenues in 2014 is due mainly to growth in products sales of label and packaging inspection solutions.

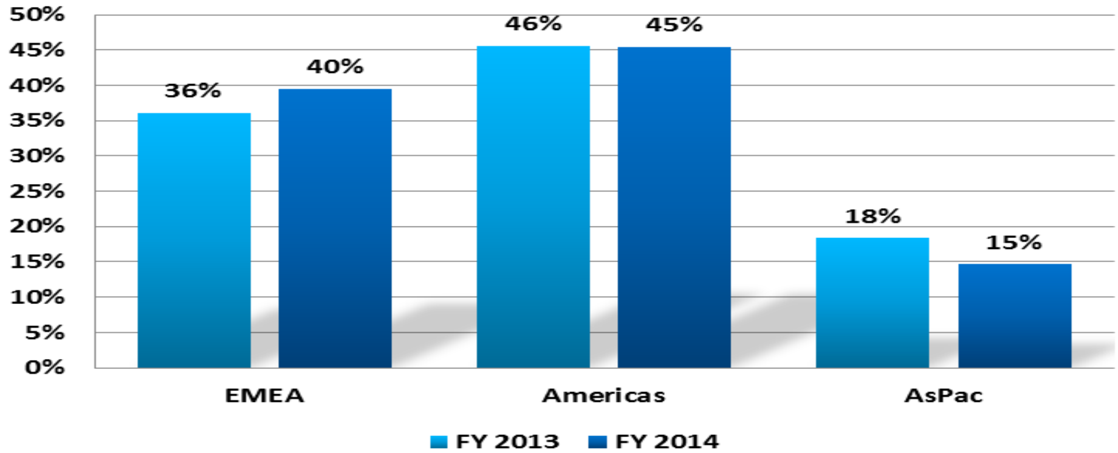
Revenues from services are generated from maintenance contracts; time and material charges; consulting and training fees, installation and sales of spare parts. We recognize revenues over the contractual period or as services are performed. Service revenues in 2014 totaled $11.8 million (out of the total revenues of $54.1 million) an increase of 5.7% compared with the $11.2 million generated in 2013. The increase in service revenues is attributable to an increased installed base of our products.

During 2014 new order booking totaled $52.9 million representing an increase of 2.5% over 2013 attributable mainly to an increase in demand for our label inspection solutions. The ratio of total new order booking to revenues in 2014 was 97.8% compared with a ratio of 102.2% in 2013. Total new order booking in the fourth quarter of 2014 was $12.3 million, lower by 14.8% as compared with the same quarter last year and the ratio of new order bookings to revenues in the fourth quarter of 2014 was 94.7%.

As of December 31, 2014 order backlog totaled $17.4 million, a decrease of 8% compared with the balance at December 31, 2013 providing us with visibility of over one quarter of revenues.

We estimate that out of this back-log, 50%-65% will become revenue during Q1 of 2015, while major part of the remainder will become revenue in the succeeding three quarters.

The following chart sets forth breakdown of revenues by territory for each of the two years ended December 31, 2014 and 2013:



In 2014 sales in the Americas contributed 45% of total revenues compared with 46% in 2013 while EMEA (Europe, Middle East & Africa) contributed 40% of total revenues compared with 36% in 2013. Revenues generated in Asia-Pacific contributed 15% of total revenues compared with 18% in 2013.

Cost of Revenues / Gross Profit

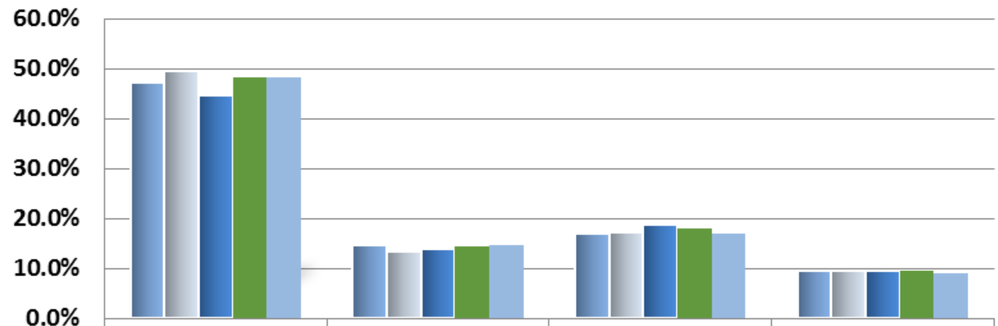
Cost of revenues includes materials, labor, manufacturing overhead and an estimation of costs associated with installation, warranty and training. We generally provide a one-year warranty to the end-user. A provision, based on our experience and engineering estimates, is recorded to cover probable costs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

Gross margin in 2014 was 52.3% compared with 53.7% in 2013. Proforma gross margin in 2014 (excluding the impact of non-cash amortization of acquired intangible assets and stock-based compensation expense) was 52.7% compared with proforma gross margin of 54.3% in 2013.

The decrease in gross margin in 2014 is due primarily to higher service costs coupled with product mix and one-off inventory adjustments partly offset by lower royalties' payments to the Chief Scientist.

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

The following table sets forth selected consolidated expenditures data for each of the five quarters ended 31.12.2014, 30.9.2014, 30.6.2014, 31.3.2014 and 31.12.2013 expressed as a percentage of total quarterly revenues:



	Cost of Revenues	R&D (net)	Selling & Marketing	General & Administrative
Q4/13	47.3%	14.6%	16.9%	9.5%
Q1/14	49.6%	13.4%	17.3%	9.5%
Q2/14	44.8%	14.0%	18.7%	9.5%
Q3/14	48.3%	14.5%	18.0%	9.5%
Q4/14	48.3%	14.7%	17.0%	9.0%

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 2014, net research and development expenses were $7,655 thousand, 5.1% higher than in 2013 ($7,287 thousand).

The gross costs of research and development are partially offset by government grants. In 2014 no government grants and participations were recorded compared with $164 thousand recorded in 2013.
Proforma net research and development expenses in 2014 (excluding the impact of non-cash stock-based compensation expense) increased by 5.1% to $7,595 thousand compared to $7,227 thousand in 2013.
The increase in net research and development expenses is due primarily to no government grants and extensive development activity which included increase in personnel cost.

Selling and Marketing

In 2014, selling and marketing expenses increased to $9,605 thousand, 6.9% higher than in 2013 ($8,983 thousand).

Proforma selling and marketing expenses in 2014 (excluding the impact of non-cash amortization of acquired intangible assets and stock-based compensation expense) increased by 7.6% to $9,503 thousand compared to $8,828 thousand in 2013.

The increase in selling and marketing expenses is attributable primarily to increased marketing activities and an increase in personnel cost.

General and Administrative

In 2014, general and administrative expenses were $5,083 thousand, similar to 2013 ($5,092 thousand).
Proforma expenses in 2014 (excluding the impact of non-cash stock-based compensation expense) were $4,959 thousand compared to $5,032 thousand in 2013. The slight decrease is mainly attributable to lower professional consultancy expenses.

Stock-Based Compensation

Based on ASC 718, commencing January 1, 2006, we record 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 2014 was $252 thousand compared with $237 thousand in 2013.

Operating and Net Income

Net income for the full year ended December 31, 2014 was $4,625 thousand or a profit of $0.76 per share (diluted) compared with net income of $6,584 thousand or a profit of $1.12 per share (diluted) in 2013.
Consolidated proforma net income for 2014 (excluding the impact of non-cash amortization of acquired intangible assets and stock-based compensation expense), was $5,131 thousand compared with proforma net income of $7,160 thousand in 2013. Net income in 2013 was positively impacted by one-time tax benefits which did not repeat in 2014.

The total amount of items excluded in proforma financial results presentation comprising of non-cash amortization of intangibles and stock-based compensation expense totaled $506 thousand in 2014 compared with a total of $576 thousand in 2013.

Consolidated proforma operating income (excluding all expense items cited above) improved by 1.7% from a profit of $6,342 thousand in 2013 to a profit of $6,454 thousand in 2014. The increase in proforma EBIT in 2014 is due to higher revenues offset by higher operating expenses.

Consolidated operating expenses were 41.3% of revenues in 2014 compared with 42.3% in 2013.

Proforma EBITDA in 2014 (excluding stock-based compensation expenses) improved by 1.5% from a profit of $6,731 thousand in 2013 to a profit of $6,831 thousand in 2014.

Financial Income (Expense), net

Financial income is comprised of interest income incurred on time deposits less bank fees and exchange rate differences.

Net financial income for 2014 was $28 thousand compared with net expense of $64 thousand for 2013. Financial income in 2014 accounted for $121 thousand compared with $115 thousand in 2013. An additional net expense of $93 thousand in 2014 was generated from exchange rate differences and bank charges, compared with $179 thousand in 2013.

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 2012 in the United States. For AVT and GMI product lines we conducted a Transfer Pricing study during 2012 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 potential tax liability in Israel and other jurisdictions.

On August 5, 2013, the Israeli parliament, the "Knesset", adopted the Law for Changing National Priorities (Legislative Amendments for Achieving Budget Targets for 2013 and 2014), 2013 which amended the Law for the Encouragement of Capital Investments ("the Amendment"). According to the Amendment, the tax rate on preferred income from a preferred enterprise in 2014 and thereafter will be 16% (in development area A - 9%).

The Amendment also prescribes that any dividends distributed to individuals or foreign residents from the preferred enterprise's earnings as above will be subject to tax at a rate of 20%.

Liquidity and Capital Resources

As of December 31, 2014 our total current assets were $44.2 million, including a total cash balance and short term deposits of $26.2 million compared with cash and financial investment balance of $26.6 million on December 31, 2013.

During 2014, $5,229 thousand were provided by operating activities compared with $8,625 thousand provided by operating activities in 2013. Our 2014 net capital expenditures on fixed assets were $457 thousand compared with $398 thousand used during 2013.

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, 2014 were 55 days compared with 57 days for the year ended December 31, 2013.

On March 21th, 2014 the Company distributed an extra- ordinary gross dividend of $1.00 per share in respect of the profits of 2013. The record date for the distribution was March 17th, 2014; while the ex-dividend date was March 18th. The tax withholding rate was 20%.

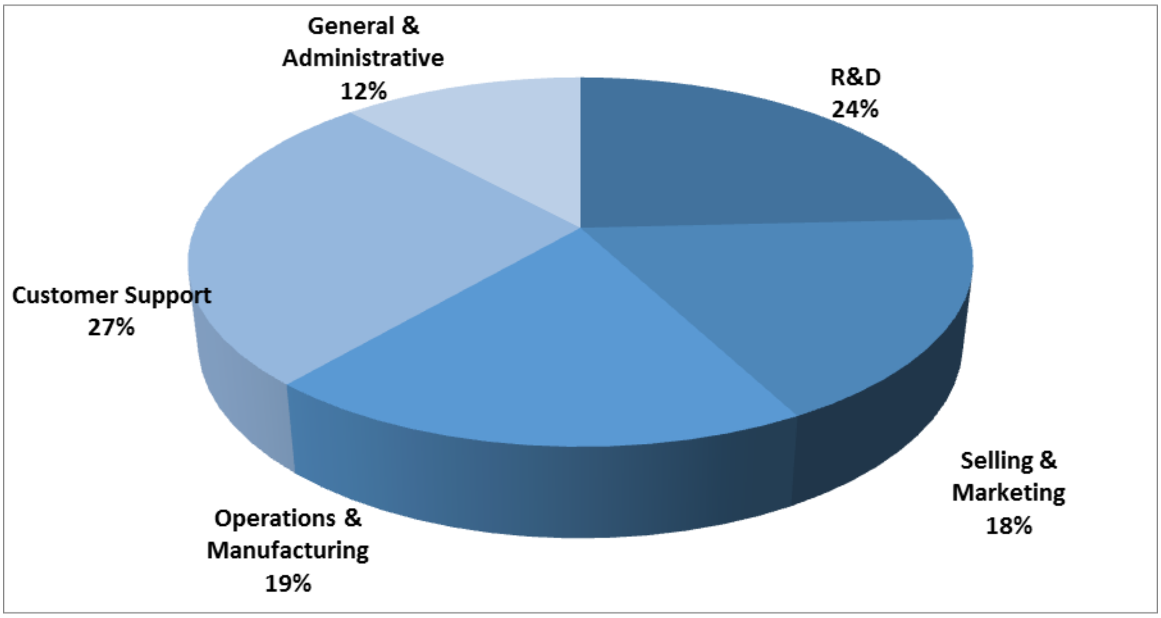
Effective October 2, 2014, the District Court in Tel Aviv, Israel, approved the Company's request to allow the reduction of its capital by up to US$12 million, after the Israeli Tax Authority informed the District Court that it does not object to the ruling. Therefore, per applicable Israeli law, the board of directors of the Company may opt to declare a distribution of dividends and/or adopt a share buy-back program, which will consume up to US$12 million of the Company's capital.

Employees

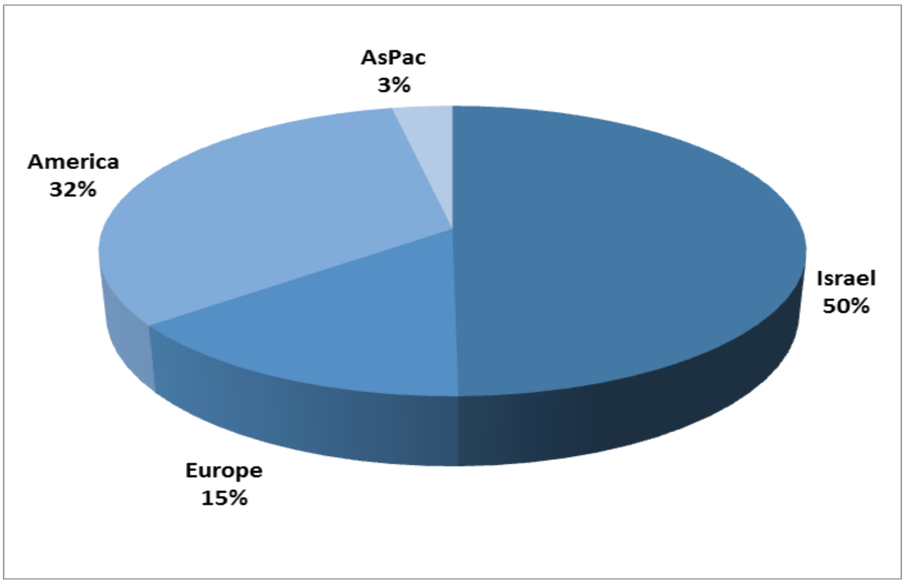
Our employees consistently remain our major asset, committed to the drive for technological leadership and outstanding customer service. Our dedicated team has repeatedly demonstrated that it shares our vision, and has the motivation, innovation and commitment to customer satisfaction that are the key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

On December 31, 2014, 217 people were employed by us worldwide compared with 198 people we employed at December 31 2013.

The breakdown of employees by activity is as follows:



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



ADVANCED VISION TECHNOLOGY (A.V.T.) LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2014

IN U.S. DOLLARS

INDEX

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Building a better
working world

Kost Forer Gabbay & Kasierer
3 Aminadav St.
Tel-Aviv 6706703, Israel

Tel: +972-3-6232525
Fax: +972-3-5622555
ey.com

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 financial statements of Advanced Vision Technology (A.V.T.) Ltd. (the "Company") and its subsidiaries which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2014, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2014 and 2013, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

Kost Forer Gabbay and Kasierer

Tel-Aviv, Israel
March 18, 2015

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

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2014	**2013**
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 15,048	$ 12,378
Short-term deposits	11,168	14,252
Trade receivables (net of allowance for doubtful accounts as of $ 869 and $ 757 as of December 31, 2014 and 2013, respectively)	8,170	7,937
Inventories	6,077	5,594
Other accounts receivable and prepaid expenses	3,740	3,420
Total current assets	44,203	43,581
LONG-TERM ASSETS:		
Deferred tax asset, net	2,233	2,521
Severance pay fund	2,811	3,320
Total long-term assets	5,044	5,841
PROPERTY AND EQUIPMENT, NET	1,269	1,189
INTANGIBLE ASSETS, NET	113	367
Total assets	$ 50,629	$ 50,978

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

CONSOLIDATED BALANCE SHEETS

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

	December 31,	
	2014	**2013**
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 3,110	$ 1,903
Employees and payroll accruals	2,696	2,619
Customer advances and deferred revenues	2,690	3,613
Accrued expenses and other liabilities	5,029	4,935
Total current liabilities	13,525	13,070
ACCRUED SEVERANCE PAY	4,186	4,805
SHAREHOLDERS' EQUITY:		
Share capital:		
Ordinary shares of New Israeli Shekels (NIS) 2 par value: 15,000,000 shares authorized at December 31, 2014 and 2013; 6,857,480 and 6,659,189 shares issued at December 31, 2014 and 2013 respectively; 6,038,358 and 5,840,067 shares outstanding at December 31, 2014 and 2013, respectively	3,714	3,602
Additional paid-in capital	65,150	64,099
Treasury shares at cost – 819,122 shares as of December 31, 2014 and 2013.	(6,902)	(6,902)
Accumulated deficit	(29,044)	(27,696)
Total shareholders' equity	32,918	33,103
Total liabilities and shareholders' equity	$ 50,629	$ 50,978

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

CONSOLIDATED STATEMENTS OF INCOME

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

	Year ended December 31, 2014	2013	2012
Revenues	$ 54,110	$ 50,498	$ 48,014
Cost of revenues	25,819	23,370	22,403
Gross profit	28,291	27,128	25,611
Operating expenses:			
Research and development	7,655	7,451	7,183
Less - grants	-	(164)	(685)
Selling and marketing	9,605	8,983	9,113
General and administrative	5,083	5,092	4,706
Total operating expenses	22,343	21,362	20,317
Operating income	5,948	5,766	5,294
Financial income (expense), net	28	(64)	(31)
Income before taxes on income	5,976	5,702	5,263
Taxes on income (tax benefit)	1,351	(882)	358
Net income	$ 4,625	$ 6,584	$ 4,905
Basic earnings per ordinary share	$ 0.77	$ 1.16	$ 0.91
Diluted earnings per ordinary share	$ 0.76	$ 1.12	$ 0.88

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 deficit	Total shareholders' equity
Balance as of January 1, 2012	$ 3,402	$ 62,655	$ (8,069)	$ (36,196)	$ 21,792
Issuance of treasury shares upon exercise of options	-	(358)	1,167	(472)	337
Stock-based compensation related to options granted to employees	-	271	-	-	271
Net income	-	-	-	4,905	4,905
Balance as of December 31, 2012	3,402	62,568	(6,902)	(31,763)	27,305
Issuance of treasury shares upon exercise of options	200	1,294	-	-	1,494
Stock-based compensation related to options granted to employees	-	237	-	-	237
Dividend paid to shareholders	-	-	-	(2,517)	(2,517)
Net income	-	-	-	6,584	6,584
Balance as of December 31, 2013	3,602	64,099	(6,902)	(27,696)	33,103
Issuance of shares upon exercise of options	112	799	-	-	911
Stock-based compensation related to options granted to employees	-	252	-	-	252
Dividend paid to shareholders	-	-	-	(5,973)	(5,973)
Net income	-	-	-	4,625	4,625
Balance as of December 31, 2014	$ 3,714	$ 65,150	$ (6,902)	$ (29,044)	$ 32,918

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

	Year ended December 31,		
	2014	**2013**	**2012**
Cash flows from operating activities:			
Net income	$ 4,625	$ 6,584	$ 4,905
Adjustments to reconcile net income to net cash provided by operating activities:			
Stock-based compensation related to options granted to employees	252	237	271
Depreciation of property and equipment	377	389	414
Amortization of intangible assets	254	339	363
Increase in trade receivables, net	(233)	(117)	(470)
Revaluation of short-term deposits	124	(80)	-
Decrease (increase) in inventories	(483)	352	478
Decrease (increase) in other accounts receivable and prepaid expenses	(396)	667	(127)
Decrease (increase) in deferred income taxes, net	364	(3,228)	94
Increase (decrease) in trade payables	1,207	587	(543)
Increase (decrease) in employees and payroll accruals	77	(69)	417
Increase (decrease) in customer advances and deferred revenues	(923)	1,269	(812)
Increase in accrued expenses and other liabilities	94	1,347	254
Increase (decrease) in accrued severance pay, net	(110)	348	144
Net cash provided by operating activities	5,229	8,625	5,388
Cash flows from investing activities:			
Investment in short-term deposits	(40)	(9,000)	(6,672)
Proceeds from maturity of short-term deposits	3,000	1,500	7,524
Purchase of property and equipment	(457)	(398)	(325)
Net cash provided by (used in) investing activities	2,503	(7,898)	527
Cash flows from financing activities:			
Dividend paid to shareholders	(5,973)	(2,517)	-
Proceeds from exercise of options granted to employees	911	1,494	337
Net cash provided (used in) by financing activities	(5,062)	(1,023)	337
Increase (decrease) in cash and cash equivalents	2,670	(296)	6,252
Cash and cash equivalents at the beginning of the year	12,378	12,674	6,422
Cash and cash equivalents at the end of the year	$ 15,048	$ 12,378	$ 12,674
Supplemental disclosure of cash flow information:			
Cash paid during the year for income taxes	$ 1,748	$ 1,431	$ 95

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

NOTE 1:- GENERAL

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

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

a. Use of estimates:

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported in the financial statements and accompanying notes. The Company's management believes that the estimates, judgment and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. 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 operates, the dollar is its functional and reporting currency. Accordingly, amounts in currencies other than dollars have been remeasured in accordance with ASC 830, "*Foreign Currency Matters*", 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 income in financial expense, net.

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

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

c. Principles of consolidation:

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

d. Cash equivalents:

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

e. Short-term deposits:

A short-term bank deposit is a deposit with a maturity of more than three months but less than one year. As of December 31, 2014, the deposits bear interest at an annual average rate of 1.14%. As of December 31, 2013, the deposits bear interest at an annual average rate of 0.85%.

f. Inventories:

Inventories are stated at the lower of cost or market. 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. For all years 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.

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

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

g. Property and equipment:

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

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

h. 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. The amortization period of the intangible assets is as follows; the Technology is amortized over 7 years, the Customer Relationships as well as the Trademarks are amortized over 10 years. 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.

Amortization expenses of intangible assets are recognized in the statement of income, in the expense category consistent with the function of the intangible asset.

i. 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, " *Property, Plant, and Equipment*" and ASC 350, *"Intangibles—Goodwill and Other"*, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. During 2014, 2013, and 2012 no indicators of impairment were identified and accordingly, no impairment losses were recorded..

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

j. Research and development costs:

Research and development costs, net of grants received, are charged to expenses as incurred.

k. Revenue recognition:

The Company derives 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 collectability 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.

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

l. Warranty costs:

The Company provides a 12 month warranty for its products at no charge. The Company estimates the costs that may be incurred during the warranty period and records a liability for the amount of such costs at the time revenue from the product sale is recognized.

m. Concentrations of credit risk:

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

Cash and cash equivalents and short-term deposits are deposited with major banks in Israel and in the United States. Such deposits in the United States may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are institutions with high credit standing, and accordingly, low credit risk exists with respect to these investments.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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. The Company maintains an allowance for doubtful accounts based upon management's experience. The allowance for doubtful accounts is determined with respect to specific debts that are doubtful of collection.

As of December 31, 2014 and 2013, the allowance for doubtful accounts amounted to $ 869 and $ 757, respectively. Bad debt expense amounted to $ 150, $ 174 and $ 157 in the years ended December 31, 2014, 2013 and 2012, respectively. The risk of collection associated with accounts receivable is mitigated by the diversity and number of customers.

n. Accounting for stock-based compensation:

The Company accounts for stock-based compensation in accordance with ASC 718, "*Compensation - Stock Compensation*". 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 statement of income.

The Company recognizes compensation expense 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 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 risk-free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. Until 2011 the Company did not intend to distribute, and did not pay any dividends. During 2012 the Company adopted a distribution policy, according to which the Company will distribute up to 50% of the Company's net income, subject to the board of directors approval, starting 2012.

U.S. dollars in thousands

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The fair value for options granted during the year are estimated at the date of grant, using the Monte Carlo simulation model with the following assumptions:

	Year ended December 31,		
	2014	2013	2012
Risk-free interest rate	1.24%	1.12%	0.74%
Suboptimal exercise multiple	2.13/2.57	2.13/2.57	2.13/2.57
Forfeiture rate	6.75%	6.45%	7.15%
Dividend yield	8.7%/4.5%	6.0%/4.5%	4.5%/0%
Expected volatility	38%	42%	49%

o. Comprehensive income:

The Company accounts for comprehensive income in accordance with ASC 220, "*Comprehensive Income*". ASC 220 establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income generally represents all changes in shareholders' equity during the period except those resulting from investments by, or distributions to, shareholders. Net income and comprehensive income of the Company are identical for all periods presented.

p. Treasury stock

On June 27, 2003, the Company repurchased some of its shares in a tender offer and thereafter held those shares as treasury shares. The Company presents the cost to repurchase treasury shares as a reduction of shareholders' equity.

Occasionally, the Company may reissue treasury shares upon exercise of options. When treasury shares are reissued, the Company charges to retained earnings the excess of the purchase cost over the exercise price and the accumulated stock based compensation. The purchase cost is calculated based on the specific identification method. If the purchase cost is less than the exercise price, the Company credits the difference to additional paid-in capital.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

q. Royalty-bearing grants:

Royalty-bearing grants from the Office of the Chief Scientist of the Ministry of Economy 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 $ 0, $ 164 and $ 685 in the years ended December 31, 2014, 2013 and 2012, respectively. Total royalties accrued or paid amounted to $ 526, $ 1,308 and $ 1,184 in the years ended December 31, 2014, 2013 and 2012, respectively and were recorded as cost of revenues.

r. Fair value of financial instruments:

The carrying amounts reported in the balance sheet for cash and cash equivalents, short-term deposits, trade receivables, other accounts receivable, trade payables and accrued liabilities approximate their fair values due to the short-term maturities of such instruments.

The Company measures the fair value based on guidance of ASC 820, "*Fair Value Measurements and Disclosures*", which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements.

The Company adopted the provisions of ASC 820, with respect to non-financial assets and liabilities measured at fair value on a non-recurring basis.

ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

s. Severance pay:

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

The deposited funds may be withdrawn only upon fulfillment of the obligation pursuant to the Israeli severance pay law or labor agreements. The value of the insurance policies is based on the cash surrender 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.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In April 2014, the Company and its employees agreed to be subject to the terms set forth in Section 14 of the Israeli's Severance Pay Law. Pursuant to Section 14, commencing from April 2014, the Company makes monthly deposits in severance pay funds based on a fixed percentage of the salary and such deposits release the Company for any severance pay obligation to the employee upon termination of employment, voluntarily or involuntarily, in respect of the period of service commencing from April 2014. Accordingly, the severance pay accrual and fund recorded in the Company's balance sheet as of December 31, 2014, reflects the severance pay liability and related deposits in respect of the service period prior to April 2014.

Severance expenses for the years ended December 31, 2014, 2013 and 2012 amounted to $ 138, $ 266 and $ 124, respectively.

t. Basic and diluted net earnings per share:

Basic net earnings per share are computed based on the weighted average number of Ordinary shares outstanding during each year.

Diluted net earnings per share are computed based on the weighted average number of Ordinary shares outstanding during the year plus dilutive potential equivalent Ordinary shares considered outstanding during the year, in accordance with ASC 260, "*Earnings Per Share*".

u. Income taxes:

The Company accounts for income taxes in accordance with ASC 740, "*Income Taxes*". ASC 740 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.

The Company accounts for its uncertain tax positions in accordance with ASC 740 which 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.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company reevaluates its income tax positions to consider factors such as changes in facts or circumstances, changes in or interpretations of tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result

in recognition of a tax benefit or an additional charge to the tax provision. The Company accrues interest and penalties related to unrecognized tax benefits in tax expense.

v. The impact of recently issued accounting standards (still not effective for the Company as of December 31, 2014) is as follows:

In May 2014, the FASB issued an accounting standard update on revenue from contracts with customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The new guidance will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard will be effective for the Company from the year beginning January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is currently evaluating the effect that the new guidance will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard, if any, on its ongoing financial reporting.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

NOTE 3:- INVENTORIES

	December 31, 2014	December 31, 2013
Raw materials	$ 2,287	$ 1,761
Work in progress	1,038	910
Finished products	1,056	1,279
Spare parts for customer support	1,696	1,644
	$ 6,077	$ 5,594

NOTE 4:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31, 2014	December 31, 2013
Government authorities	$ 1,733	$ 1,169
Prepaid expenses	538	582
Deferred taxes	1,322	1,398
Other accounts receivable	147	271
	$ 3,740	$ 3,420

NOTE 5:- PROPERTY AND EQUIPMENT

	December 31, 2014	December 31, 2013
Cost:		
Computers and peripheral equipment	$ 3,559	$ 3,348
Machinery and equipment	1,794	1,715
Office furniture and equipment	622	621
Leasehold improvements	654	488
	6,629	6,172
Accumulated depreciation:		
Computers and peripheral equipment	3,151	2,989
Machinery and equipment	1,485	1,351
Office furniture and equipment	421	380
Leasehold improvements	303	263
	5,360	4,983
Property and equipment, net	$ 1,269	$ 1,189

U.S. dollars in thousands

NOTE 5:- PROPERTY AND EQUIPMENT (Cont.)

Depreciation expense for the years ended December 31, 2014, 2013 and 2012 was $ 377, $ 389 and $ 414, respectively.

NOTE 6:- INTANGIBLE ASSETS, NET

	December 31, 2014	December 31, 2013
Cost:		
Technology	$ 3,767	$ 3,767
Customer Relationships	670	670
Trademarks	298	298
	4,735	4,735
Accumulated amortization:		
Technology	3,767	3,576
Customer relationships	627	591
Trademarks	228	201
	4,622	4,368
Intangible assets, net	$ 113	$ 367

Amortization expense amounted to $ 254, $ 339 and $ 363 for the years ended December 31, 2014, 2013 and 2012, respectively.

U.S. dollars in thousands

NOTE 6:- INTANGIBLE ASSETS, NET (Cont.)

Estimated amortization expense for the years ended:

December 31,		
2015	$	48
2016		37
2017		28
	$	113

NOTE 7:- ACCRUED EXPENSES AND OTHER LIABILITIES

	December 31,			
	2014		2013	
Provision for warranty costs	$	776	$	703
Government authorities		-		656
Income taxes payable		2,343		1,849
Accrued expenses and other liabilities		1,910		1,727
	$	5,029	$	4,935

NOTE 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 2019.

Future minimum lease commitments under non-cancelable operating leases as of December 31, 2014, are as follows:

Year	Lease commitment	
2015	$	872
2016		103
2017		91
2018		88
2019		15
	$	1,169

NOTE 8:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

Total rent expense for the years ended December 31, 2014, 2013 and 2012 amounted to $ 2,648, $ 2,565 and $ 2,487, respectively.

The Company leases motor vehicles under cancelable operating lease agreements. The Company has an option to be released from this agreement, which may result in penalties in a maximum amount of $ 27 as of December 31, 2014.

b. Royalty commitments:

The Company was committed to pay royalties to the Chief Scientist of Israel's Ministry of Economy 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 plus interest at the applicable LIBOR rate at the time the grants were received.

In January 2014 the Company decided to early repay the above mentioned contingent obligation, in the amount of $656K thereby met the entire obligation to the Chief Scientist.

c. Legal proceedings:

From time to time the Company is a party to various litigation matters incidental to the conduct of its business. There is no pending or threatened legal proceeding to which the Company is a party that, in its opinion, is likely to have a material adverse effect on its future financial results.

d. Liens:

To secure its line of credit for bank guarantees, the Company has recorded a fixed lien of $ 140 on a cash deposit.

NOTE 9:- INCOME TAXES

a. General

The Company operates within multiple taxing jurisdictions (primarily in Israel and in the U.S.) 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 rates:

Taxable income of Israeli companies is subject to tax at the rate of 25% in 2012 and 2013 and 26.5% in 2014 and future years.

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

Substantially all of the Company's production facilities in Israel have been granted status as an "Approved Enterprise" or a "Privileged Enterprise", under the Law, in four investment programs, which provides certain benefits, including tax exemptions and reduced tax rates. Income not eligible for Approved Enterprise and Privileged Enterprise benefits is taxed at a regular tax rate.

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the Law and regulations published thereunder. Should the Company have failed to meet such requirements, income attributable to its Approved Enterprise and Privileged Enterprise programs could be subject to the statutory Israeli corporate tax rate and the Company could be required to refund a portion of the tax benefits already received, with respect to such programs. As of December 31, 2014, management believes that the Company is in compliance with all the conditions required by the Law.

Previously, in the event of distribution of dividends from the said tax-exempt income, the amount distributed would have been subject to corporate tax at the rate ordinarily applicable to the Approved or Privileged Enterprise's income. The tax-exempt income attributable to the "Approved Enterprise" programs mentioned above could have been distributed to shareholders without subjecting the Company to taxes only upon the complete liquidation of the Company. Tax-exempt income generated under the Company's Privileged Enterprise program would have been subject to taxes upon dividend distribution (which includes the repurchase of the Company's shares) or complete liquidation.

NOTE 9:- INCOME TAXES (Cont.)

Prior to 2013, the Company did not intend to distribute any amounts of its undistributed tax exempt income as dividends as it intended to reinvest its tax-exempt income within the Company. Accordingly, no deferred income taxes were provided on income attributable to the Company's Approved or Privileged Enterprise programs as the undistributed tax exempt income was essentially permanent in duration.

In November 2012, as a temporary fiscal raising measure, an order was passed in Israel intended to encourage companies to voluntarily elect for an immediate payment of corporate tax on previously tax-exempted earnings which were earned pursuant to Approved and Privileged Enterprises (the "Order"). The Order did not require the actual distribution of these previously tax-exempted earnings.

The Order provided, for those companies which so elect before November 2013, partial Israeli tax relief calculated on a linear basis: the greater the release of the previously tax-exempted earnings, the higher the relief from corporate tax which otherwise would have applied upon an actual distribution. According to the statutory linear formula provided in the Order, the corporate income tax to be paid would vary from a 6% to a 17.5% effective tax rate.

During March and November 2013, the Company made the election and duly released all of its previously tax-exempted earnings related to its various Approved and Privileged Enterprise Programs. As a result of the election, the Company recorded an expense of $1,373. Subsequent to the election, the Company no longer has a tax liability upon future distributions of its past tax-exempted earnings.

During December 2010, the Law for Economic Policy for 2011 and 2012 (Amended Legislation) was passed, and among other things, amended the Law, ("the Amendment") effective January 1, 2011. According to the Amendment, the benefit tracks in the Investment Law were modified and a flat tax rate applies to the Company's entire preferred income (as part of its "Preferred Enterprise"). The Company elected for the Preferred Enterprise regime to apply (the waiver is non-recourse) and is subject to the tax rates as follows: 2012 - 15%, 2013 - 12.5% and 2014 and thereafter - 16%.

c. Carryforward tax losses:

As of December 31, 2014, the U.S. subsidiary had U.S. federal carryforward tax losses of approximately $ 2,735 that can be carried forward and offset against taxable income for 12-20 years and expire from 2020-2028. The Tax Return Act of 1986 limits the use of net operating loss and tax credit carry forwards in certain situations where changes occur in the stock ownership of a company. Due to the change in ownership that occurred at the end of 2009, the utilization of the abovementioned carry forwards are likely to be subject to limitation of section 382 to the IRS regulations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 9:- INCOME TAXES (Cont.)

As of December 31, 2014, the German subsidiary used all its carry forward tax losses.

d. 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, 2014, 2013 and 2012, the Company's deferred taxes were in respect of the following:

	December 31,	
	2014	**2013**
Deferred tax assets:		
Net operating loss carryforwards	$ 1,002	$ 1,209
Different amortization rates of intangible assets	1,660	1,821
Reserves and allowances	3,430	3,210
Deferred tax assets before valuation allowance	6,091	6,240
Valuation allowance	(2,515)	(2,290)
Deferred tax assets	3,576	3,950
Deferred tax liability:		
Different depreciation rates of property and equipment	(22)	(31)
Total deferred tax liability	(22)	(31)
Net deferred tax asset	$ 3,555	$ 3,919

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 9:- INCOME TAXES (Cont.)

	December 31, 2014	December 31, 2013
Domestic:		
Current deferred tax asset	$ 602	$ 528
Non-current deferred tax asset	491	471
	1,093	999
Foreign:		
Current deferred tax asset	720	870
Non-current deferred tax asset	4,279	4,371
Non-current deferred tax liability	(22)	(31)
Valuation allowance	(2,515)	(2,290)
	2,462	2,920
	$ 3,555	$ 3,919

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

	Year ended December 31, 2014	2013	2012
Domestic	$ 4,269	$ 2,800	$ 2,432
Foreign	1,707	2,902	2,831
	$ 5,976	$ 5,702	$ 5,263

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 9:- INCOME TAXES (Cont.)

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

	Year ended December 31,		
	2014	**2013**	**2012**
Current	$ 987	$ 3,138	$ 264
Deferred	364	(4,020)	94
	$ 1,351	$ (882)	$ 358
Domestic:			
Current	$ 771	$ 2,034	$ 233
Deferred	(94)	(308)	94
	$ 677	$ 1,726	$ 327
Foreign:			
Current	$ 216	$ 1,104	$ 31
Deferred	458	(3,712)	-
	$ 674	$ (2,608)	$ 31

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands

NOTE 9:- INCOME TAXES (Cont.)

g. Reconciliation of the theoretical tax expense:

	Year ended December 31,		
	2014	**2013**	**2012**
Income before taxes on income	$ 5,976	$ 5,702	$ 5,263
Statutory tax rate	26.5%	25%	25%
Theoretical tax expenses (benefit) at statutory tax rate	$ 1,584	$ 1,426	$ 1,316
Increase (decrease) in respect of:			
Losses, reserves and allowances for which valuation allowance was provided	6	87	102
Utilization of carryforward losses for which valuation allowance was provided in prior year	(31)	(728)	(970)
Elimination of valuation allowance for losses, reserves and allowances	-	(2,920)	-
Tax adjustment in respect of "Preferred Enterprise" status	(448)	(393)	(504)
Tax adjustment in respect of foreign subsidiaries different tax rates	205	197	237
Expense related to the election to release previously tax-exempted earnings under the Order described in Note 9(b)(2) above	-	1,373	-
Stock-based compensation expense	67	59	71
Non-deductible expenses	53	53	36
Other	(85)	(36)	70
Actual tax expense (benefit)	$ 1,351	$ (882)	$ 358

h. The balance sheet at December 31, 2014 and 2013, include a liability for unrecognized tax benefits of $ 747, with respect to taxation of certain of the Company's income under foreign jurisdictions as well as certain limitations of the utilization of carryforward losses. The Company recognizes interest accrued and rate differences related to unrecognized tax benefits as tax expense.

NOTE 9:- INCOME TAXES (Cont.)

i. The Company and its subsidiaries are routinely examined by various taxing authorities. A.V.T. Ltd. has received final tax assessments in Israel through 2011, the Company's tax year 2012 through 2014 remains subject to examination by the Israeli Tax Authorities.
As a result of net operating loss carryforwards, the U.S. subsidiaries tax years 2009 through 2013 remain subject to examination by the IRS for U.S. federal tax purposes and for tax years 2008 and forward for state purposes. There are tax years which remain subject to examination in various other jurisdictions that are not material to the Company's financial statements.

NOTE 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.

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. Through December 31, 2013, a total of 623,000 treasury shares were issued to certain investors and 448,630 treasury shares were issued to employees as result of exercise of options made by them. As of December 31, 2014 and 2013, the Company is holding 819,122 treasury shares.

On October 2, 2014, the District Court in Tel Aviv, Israel, approved the Company's request to allow the reduction of its capital by up to $12,000, after the Israeli Tax Authority informed the District Court that it does not object to the request. Therefore, subject to applicable Israeli law in respect of dividend distributions, the board of directors of the Company may opt to declare a distribution of dividends and/or adopt a share buy-back program, which will reduce up to $12,000 of the Company's capital.

c. Stock option plans:

Under the 2003 and 2009 Stock Option Plans, 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 optionee'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.

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

NOTE 10:- SHARE CAPITAL (Cont.)

A summary of the stock option activities in 2014 is as follows:

	Amount	Weighted average exercise price	Weighted average remaining contractual life	Aggregate Intrinsic value
Outstanding at January 1, 2014	604,889	7.02	3.82	
Granted	191,366			
Exercised	(198,291)			
Forfeited	(105,699)			
Outstanding at December 31, 2014	492,265	9.27	4.89	*) 1,040
Vested and expected to vest at December 31, 2014	421,557	9.08	4.75	**) 970
Exercisable at December 31, 2014	99,489	6.90	2.21	***) 481

*) Represents intrinsic value of 287,400 outstanding options that are in-the-money as of December 31, 2014. The remaining 204,865 outstanding options are out of the money as of December 31, 2014 and their intrinsic value was considered as zero.

**) Represents intrinsic value of 257,890 vested and expected to vest options that are in-the-money as of December 31, 2014. The remaining 163,667 vested and expected to vest options are out of the money as of December 31, 2014 and their intrinsic value was considered as zero.

***) Represents intrinsic value of 73,661 exercisable options that are in-the-money as of December 31, 2014. The remaining 25,828 exercisable options are out of the money as of December 31, 2014 and their intrinsic value was considered as zero.

As of December 31, 2014, $ 663 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.86 years.

The weighted-average grant-date fair value of options granted during the years 2014, 2013 and 2012 was $ 2.25, $ 2.09 and $ 2.33, respectively. The total intrinsic value of options exercised during the years ended December 31, 2014, 2013 and 2012, was $ 1,195, $ 1,427and $ 449, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 10:- SHARE CAPITAL (Cont.)

Following are the outstanding options by exercise price as of December 31, 2014:

	Outstanding			Exercisable		
Exercise price	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average remaining contractual life (years)	Weighted average exercise price
$			$			$
0	15,150	2.28	0	15,150	2.28	0
2.56-3.97	21,300	1.86	3.64	19,450	1.86	3.64
5.65-9.83	230,405	3.91	7.97	37,211	1.99	6.86
10.69-11.87	194,410	6.75	11.44	4,328	4.97	11.21
12.07-15.45	31,000	3.87	13.69	21,500	2.33	14.40
	492,265	4.89	9.27	99,489	2.21	6.90

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

	Year ended December 31,		
	2014	2013	2012
Cost of revenues	$ 27	$ 45	$ 53
Research and development	60	60	67
Selling and marketing	41	72	90
General and administrative	124	60	61
Total stock-based compensation expense	$ 252	$ 237	$ 271

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 11:- EARNINGS PER SHARE

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

	Year ended December 31,		
	2014	2013	2012
Net income	$ 4,625	$ 6,584	$ 4,905
Weighted average number of Ordinary shares used in computing - Basic EPS	5,984,182	5,669,624	5,389,243
Dilutive effect:			
Employee stock options	114,738	220,747	210,753
Weighted average number of Ordinary shares used in computing - Diluted EPS	6,098,920	5,890,371	5,599,996
Basic earnings per share	$ 0.77	$ 1.16	$ 0.91
Diluted earnings per share	$ 0.76	$ 1.12	$ 0.88

The total numbers of options excluded from the calculation of diluted net earnings per share, as they would have an anti-dilutive effect were 225,652, 258,258 and 377,098 for the years ended December 31, 2014, 2013 and 2012, respectively.

NOTE 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 the U.S. include research and development, marketing and sales. Operations in Europe include marketing, support and sales. The following is selected information according to geographic areas:

	Year ended December 31,		
	2014	2013	2012
Revenues based on the customer's location:			
United States	$ 24,691	$ 23,083	$ 21,511
Europe (other than Germany and Israel)	17,537	14,442	15,659
Germany	3,541	3,126	3,246
Israel	251	381	509
Other	8,090	9,466	7,089
	$ 54,110	$ 50,498	$ 48,014

	December 31,	
	2014	2013
Long-lived assets by geographic location:		
Israel	$ 757	$ 784
United States	491	372
Europe	21	33
	$ 1,269	$ 1,189

NOTE 13:- SELECTED STATEMENT OF INCOME DATA

a. Revenues:

	Year ended December 31,		
	2014	2013	2012
Revenues:			
Products	$ 42,273	$ 39,301	$ 37,166
Services	11,837	11,197	10,848
Total Revenues	$ 54,110	$ 50,498	$ 48,014

b. Financial income (expense), net:

	Year ended December 31,		
	2014	2013	2012
Financial income:			
Interest	$ 121	$ 115	$ 179
Foreign currency translation differences, net	55	24	-
	176	139	179
Financial expenses			
Bank charges and other	148	203	193
Foreign currency translation differences, net	-	-	17
	148	203	210
	$ 28	$ (64)	$ (31)

NOTE 14:- SUBSEQUENT EVENT

On March 18, 2015, the board of directors has resolved to distribute an extra-ordinary gross dividend of $1.0 per share which will be paid on April 2, 2015.

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Report of the Board of Directors

Dear Shareholders,

First, I would like to thank Mr. Agassi for his contributions and accomplishments as AVT's Chairman for the past 6 years. I am also very glad that Mr. Agassi decided to continue serving as a Director on the AVT Board so he can continue contributing to the success of the Company.

In 2014 we have seen continued improvement in our business. AVT continued to expand its businesses and achieved continuous profitability. During 2014 the Board of Directors performed its 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.

During 2014, six new executives joined the Company: Mr. Udi Bar Sela – Chief Financial Officer, Mr. Windell McGill – President AVT Inc., Mr. Yair Shaharabany – Chief Operation Officer, Mr. Amir Sheinman- VP Marketing, Mr. Tim Van den Bossche- President, AVT Europe and Mrs. Merav Yanai- VP Human Resource and Business Processes. All new executives bring vast experience in different fields and more strength to the management team. I believe this management team will add significant value to the Company, and with the leadership of the Company's president and CEO, Jaron Lotan, who joined in late 2013, t management is well positioned to lead the Company through these exciting times. I expect this management team to drive new initiatives and execute a strategy that will take the Company forward.

Effective October 2, 2014, the District Court in Tel Aviv, Israel, approved the Company's request to allow the reduction of its capital by up to US$12 million. Therefore, per applicable Israeli law, the Board of Directors of the Company may opt to declare a distribution of dividends and/or adopt a share buy-back program, which will consume up to US$12 million of the Company's capital.

On March 18, 2015, in light of the Company's high level of cash reserves the Board of Directors resolved to distribute an extra-ordinary gross dividend of $1.0 per share For 2015 we have a plan to generate further top line growth while putting more emphasis on new areas of growth, both in new technologies and new geographies and by continuing to form new partnerships to assure faster growth in 2016 and beyond.

As of December 31, 2014, the Board of Directors consisted of 6 members, including 2 external Directors. Board meetings focused on strategies for profitable growth, both organic and non-organic, introduction of new products, corporate governance, opening up of new markets' and new 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, including the 2 external directors, one of whom serves as the Chairman, and an additional non-affiliated director who meets certain independence criteria and is neither an officer of the Company nor the chairman. The committee is responsible, among other issues, for the review of the financial statements, the accounting standards applicable to the Company and financial issues subject to management judgment. The committee is also responsible for the nomination of the Company's Internal Auditor, approval of his annual audit plan, review of his final report, and the supervision of implementation of his recommendations. In addition, the Board of Directors has a Compensation Committee consisting of three directors, including both External Directors, one of whom serves as its Chairman. The Compensation Committee developed a multi-year compensation policy for AVT's officers and directors in accordance with

Israeli law. This policy was approved by the Board and subsequently by the shareholders on December 23, 2013 and was amended on December 18, 2014. In addition, the Compensation Committee reviews and provides recommendation to the Board of Directors with respect to directors' and officers' terms of office and employment, including bonuses, stock option grants and other forms of compensation, all as required under Israeli law.

During 2014, we held 6 Board of Directors meetings, 6 Audit Committee meetings and 5 Compensation Committee meetings. All Board of Directors meetings consisted of a legal quorum of at least four attendees and the Audit and Compensation Committee meetings were attended by at least 2 Directors as required by Israeli Law.

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, 2014 and 2013, and the related consolidated statements of income, changes in shareholders' equity and cash flow for each of the three years ended December 31, 2014, were audited by KOST FORER GABBAY & KASIERER, a member of Ernst & Young Global.

In the Audit Committee meeting held on March 16, 2015 and Board of Directors meeting held on March 18, 2015, attended by the Company's auditors and legal counsel, we discussed the 2014 Financial Statements and resolved to approve the Annual Report.

I would like to thank our customers for their business and for their continued confidence in AVT and to our management team, employees, partners and suppliers for their hard work and contribution to our growth and success.

Hod Hasharon, March 18, 2015

Dan Falk
Chairman