UPGRADING
EVERYDAY
SECURITY

The Annual Report's Management Discussion and Analysis (the "Report")

1. Market Overview and Operational Activities

General economic conditions[1]

The World alarm monitoring services market is forecasted to reach US$ 65.3 billion by the year 2017 (Global Industry Analysts, Inc.) as the economy is expected to improve in the short to medium term period. Thus, the alarm monitoring market will regain lost momentum, encouraged by the fact that security installations will continue to remain a key feature in modern housing constructions.

Over the years, the global alarm monitoring services industry has been garnering considerable business, driven by rising concern about crime in society. Security services are currently a vital component in the safety & security plans of homeowners and organizations across the globe. Incremental technology development include rise in products sophistication and falling prices have helped expending demand in the market. Industry analysts expect these trends to further accelerate the rate of growth in the market.

Alarm monitoring services are expected to experience healthy growth in the upcoming years as is already evident by the resurgence in growth in the year 2010 for most market across the globe. Expected recovery in the construction space in 2012 is expected to put the growth momentum back on track. Additionally, government support in the form of sponsored economic stimulus packages for the construction industry, and national reserve bank's monetary easing program is also helping indirectly supporting demand for alarm monitoring solutions. Increased infrastructure spending, improvement in liquidity situation, softening of interest rates, and continued urbanization, will help drive growth back to the fore. In the post recession period, alarm dealers are expected to focus on niche markets within the security space in order to remain competitive. According to Global Industry Analysts, Inc., demands for new burglar alarm panels will continue to accelerate, adding more value and convenience with advance technologies such as touch screens, synergies with GSM communications (two way voice and data), as well as home automation capacity.

[1] Global Industry Analysts, Inc.

Business Overview

Electronics Line 3000 Ltd. ("EL" or the "Company") is a pioneer in next-generation security solutions for the residential and small commercial markets. The Company designs and produces cutting-edge solutions for security and control of living and working environments. The EL line provides comprehensive security protection, as well as sophisticated system and home management functionality, for optimal comfort, safety and peace of mind. This new industry standard is further upgraded with enhanced remote management capabilities that give homeowners instant access to their system from anywhere in the world.

Upgrading Everyday Security

EL solutions enable new levels of control and maintenance in protected sites through the ELAS, a proprietary remote management server. The Company enjoys a unique market position in supplying ELAS-governed systems for the home and workplace, which provide the multiple benefits of a virtual security presence, convenient home automation, and energy efficiency, all customized by the end-user and/or the service provider.

EL's extensive product line includes both wired and wireless solutions, as well as the integration of both types into one hybrid system. EL solutions offer enhanced detection and PSTN/IP/GSM/GPRS-based event reporting, along with advanced remote management tools. The back-office support and customized branding of EL solutions provide superior security with significant business benefits and market expansion potential.

Global Partnerships

Nearly three decades of cutting-edge leadership have earned EL a solid market position, allowing users worldwide to benefit from EL's ongoing development of upgraded security solutions.

The Company maintains long-term partnerships worldwide.

EL has made emerging technology, user-friendly design and exceptional quality the benchmarks for serving its international network of clients and partners. Drawing on a tradition of pioneering expertise, EL specialists also provide security integration consultancy, installation service, training and technological support.

EL was established in 1982 and is headquartered in Israel. The Company is publicly traded on the Frankfurt Stock Exchange (ELN) and is part of the RISCO Group, an established leader in the international security market.

In March 2010 RISCO Group, a leading provider of integrated security solutions, acquired control interest in the Company. RISCO Group's intention is to maintain the Company's independent standing in the market and its product offerings by growing the Company to become the residential arm of RISCO Group by expanding the product portfolio into video and management solutions together with its major partners worldwide.

In order to increase the Company's global coverage and have better penetration into new and existing markets, the Company entered, on August 2010, into management and distribution agreements with Risco Ltd. ("Risco"), as Risco has the facilities to import, promote, sell, market and distribute the products in the territory (as defined in the agreement) and is willing to act as the supplier's non-exclusive distributor of the "Products in the Territory".

During 2011, the Company has outsourced its production activities both to sub-contractors and to Risco Ltd., in order to achieve better efficiency and margins.

Due to the reduction of costs and streamlining of production, this reorganization entails an increase in profitability in 2011.

The Company reorganized its sales force in order to achieve a better coverage in its target markets. Mr. Douglas Luscombe, the Company's CEO, was located in the UK, several new Regional Sales Managers (RSM) were assigned to cover the rest of Europe and the Russian markets.

The Company has a presence, and believes it is well positioned in important markets around the world, in particular Northern and Western Europe and consistently strengthens its position in additional regions in Latin America, APAC and more. The Company's brand is associated with high quality products and solutions.

The Company continues to develop and expand its marketing and sales capabilities with a focus on strategic customers and markets, while at the same time, providing more marketing and technical support to existing customers due to the tough economic situation in certain countries.

Products and Product Families

The Company offers an array of security solutions for every need. EL's wireless, wired and hybrid control systems enable as much or as little control and supervision over the home environment as users require.

Advanced security detectors supply excellent interior and perimeter protection while safety detectors offer enhanced environmental and personal safety including: smoke, gas and water leak detection, panic buttons and much more.

The systems can be activated using a variety of local control devices such as keyfobs, keypads and tag readers. We also offer end-users and providers advanced remote management applications for comprehensive control over the system from any location.

Complementing accessories and add-ons include home automation modules, zone expanders, receivers, sirens and more for a complete security offering.

The EL Application Server (**ELAS**) is a 24/7 dedicated application server, which provides an answer to the growing demand for customer autonomy. The ELAS offers private remote access to EL security systems, allowing homeowners to easily check, activate, modify and communicate with their security system from anywhere in the world, through web-based or smartphone applications.

The sophisticated **iConnect** system, with its sleek design, serves as the command center for a residential and small commercial Security and Home Automation network.

Powered by the full range of ELAS remote management functions, iConnect effortlessly integrates remote signaling from end-users, monitoring stations, service providers and technicians. The ELAS enables remote programming and maintenance of the iConnect system by Internet or smartphones, built-in interface with PSTN/GSM/GPRS communication modules, configuration of email and SMS event notification to users, and much more.

The two-way wireless RF technology built into iConnect also enables the use of PIR Cameras for event triggered video images and clips, as well as video verification. The compatible EL two-way peripherals communicate with the iConnect control panel and respond to RF signals with top-level data security. Designed for superior efficiency, the peripherals only respond to signals when the control panel is armed, and then they act with enhanced speed to minimize energy consumption and signal traffic congestion.

CommPact, named for its streamlined, space-saving design (21x15.2x4cm), offers cost effective security and connectivity, with all the essential functions of one-way wireless technology available in one small high-powered package.

The simple wireless installation and advanced remote management capabilities of CommPact provide an ideal value-for-money solution, which allows users to enjoy a complete sense of control and peace of mind.

CommPact's remote management is driven by the ELAS, The advanced features include remote programming and maintenance of the CommPact system by Internet or smartphone, built-in interface with PSTN/GSM/GPRS communication modules, configuration of email and SMS event notification to users, and stand-alone two-way audio capability.

An established, field-proven solution using one-way wireless FM technology, **Prime** features modular flexibility. Security, safety and comfort receive equal priority, with features that enable Home Automation.

The robust Prime system takes advantage of PSTN and/or GSM connectivity and is compatible with all of EL's wireless keypads and other peripherals. Service providers and end-users can customize Prime in all its essential functions: SMS event notifications, remote installation of programs and upgrades, audio communication, range extension and more.

Business Strategy

The Company engages in the design, development, production, marketing and sales of next-generation security solutions for the residential and small commercial markets.

The Company's vision is to be a leading global provider of wireless security with remote management solutions for the mass residential and small commercial markets.

Key elements of the Company's growth strategy include:

- Continuing to position the Company's wireless products as an innovative quality solution that reduces operating expenses for the service provider and increases functionality and control for the end user.
- Developing and strengthening relationships with key target customers in order to sell to their customers the wireless security with remote management solutions.
- Providing a full range of market solutions – from standard, low cost solutions to high end, advanced solutions
- Increasing services which are available as part of the Company's platform for remote management solutions, including advanced video capabilities, remote management applications and more.
- Leveraging wireless technology and various platforms to develop new solutions.
- Invest in both short-term and long-term R&D in order to improve product design and lower production costs.

2. OPERATING AND FINANCIAL REVIEW for 2011

The consolidated financial statements of the Company and its subsidiaries as of December 31, 2011 have been prepared in accordance with the International Financial Reporting Standards (IFRS).

During the period from January 1 to December 31 of fiscal 2011 ("Reporting Period") a new business plan for the Company has been put in place.

As part of that plan, the Company had to complete the development of its new product line (ELAS, iConnect2 way and CommPact), restructure its sales division, outsource its production activity and increase its operating expenses efficiency.

The number of employees decreased from 149 as at December 31, 2010 to 31 as of December 31, 2011. The reduction was caused by the Company's decision to outsource administrative, distribution and production resources.

Earnings

The Company is facing internal and external challenges due to the recent developments in the global economy as well as from the implementation of the new business plan. Global economic developments have affected the Company's 2011 and 2010 performances and results, its customers and suppliers and introduced new settings and opportunities for the future.

On November 28, 2011, the Company sold its UK subsidiary in a Management Buyout transaction.

Under the Management Buyout agreement, the Company receives a consideration of GBP 1.8 million which was paid in cash at the closing date. Inventory valued at GBP 130 thousand was returned to the Company, without any additional consideration.

During 2011, the Company recorded a gain from the sale of a subsidiary in the total amount of US$1.224 million.

The Company's revenues in the Reporting Period amounted to US$ 24.2 million, compared to US$ 26.7 million for the year ended December 31, 2010.

The gross margin for the Reporting Period amounted to US$ 8.4 million or 34.8% compared to US$ 8.4 million or 31.4% last year. The margin increase resulted from efficiency gains and the use of outsourcing partners. The gross margin for 2011 was affected by an increase in provision of slow moving inventory in the total amount of US$ 560,000.

Total operating expenses for the Reporting Period amounted to US$ 6.9 million, compared to US$ 13.3 million in the comparable year. The decrease in operating expenses is mainly due to onetime, non-cash, expenses of US$ 4.3 million the Company had to record as a result of outsourcing its production activity in the comparable year.

The tax on income for the Reporting Period amounted to US$ 54 thousands, compare to US$ 523 thousands in the comparable year. The decrease in tax on income is mainly due to US$ 379 thousands one-time, non-cash expenses the Company had to register due to changes in tax principals in UK which affected its UK subsidiary in the comparable year.

The net profit for the Reporting Period amounted to US$ 2.3 million, compared to a net loss of US$ 5.8 million in the comparable year. The adjusted net profit, not considering one-time effects from the sale of a subsidiary, amounted to US$ 1.1.

The Cost of Goods sold amounted to US$ 15.7 million (65.2%) compared to US$ 18.3 million (68.6%) in the comparable year.

The research and development expenses amounted to US$ 1.7 million during the Reporting Period, compared to US$ 1.9 million in the comparable year. Research and Development expenses included the amortization of US$ 100,000 production files that were previously capitalized as intangible assets, while the related product (CommPact) was under development.

The selling and marketing expenses amounted to US$ 2.9 million during the Reporting Period, compared to US$ 3.8 million in the comparable year.

The decrease in selling and marketing expenses is due to better efficiency, expense savings, and the implantation of the management service agreement between Risco and the Company as mentioned below.

The Company continues to develop and expand its marketing and sales capabilities with a focus on strategic customers, while at the same time, providing more marketing and technical support to existing customers due to the tough economic situation in certain countries.

On August 12, 2010, the Company entered into distribution agreements with Risco, as Risco has the facilities to import, promote, sell, market and distribute the certain products in certain territories (as defined in the agreement) and is willing to act as EL's non-exclusive distributor of those Products in the respective territories.

The General and Administrative expenses amounted to US$ 2.0 million during the Reporting Period, compared to US$ 3.2 in the comparable year.

Decrease in general and administrative expenses is due to a new business plan put in place during 2011, among others expenses savings, terminating advisors services agreements, and implementation of the management service agreement between the Company and Risco as mention below:

On August 12, 2010, the Company entered into management service agreements with Risco Ltd. As Risco is willing to exert its efforts and utilize its professional connections in order to assist the Company in the following fields: (i) sales administration services; (ii) IT and computerized systems; (iii) Finance management and accounting; (iv) human resources; (v) directors and consulting services; (vi) legal and company secretarial services.

The Company's Financial Position

Following the Management buy-out transaction of its UK-subsidiary from November 28, 2011, all assets and liabilities as of December 31, 2011 apply to the Company ongoing operations stand alone, while in the comparable period ended at 31 December, 2010, assets and liabilities of the subsidiary are consolidated with the assets and liabilities of the ongoing operations.

The Company's cash and cash equivalents as of December 31, 2011 (hereinafter: "the Reporting Date") were US$ 1.7 million, compared to US$ 1.0 million on December 31, 2010. The increase is mainly due to cash provided by investing activity, proceeds from sales of investment in previously consolidated subsidiary in the amount of US$ 2.1 million and cash used in financing activity in the amount of US$ 900,000.

The Company's trade receivables on the Reporting Period were US$ 2 million, compared to US$ 3 million on December 31, 2010.

The Company's prepaid expenses, other accounts receivables, advance payments to suppliers and income tax receivables on the Reporting Period were US$ 1.9 million, compared to US$ 1.5 million on December 31, 2010.

The Company's inventories on the Reporting Period were US$ 1.4 million compared to US$ 5.5 million in the comparable year.

Net investment in property, plant and equipment, on the Reporting Date amounted to US$ 500,000, compare to a US$ 2 million investment in the comparable year.

The short term credit balance from banks and related parties on the Reporting Date amounted to US$ 1.2 million, compared to US$ 7.3 million in the comparable year. The decrease in short terms credit is mainly due conversion of debt to equity in a private issuance of 3.55 million ordinary shares to the controlling shareholder, Risco Ltd.

The Company's trade payables as of the Reporting Date were US$ 2.8 million compared to US$ 5 million in the comparable year.

Other current liabilities, accrued expenses and income tax payable were US$ 1 million, compared to US$ 2.3 million in the comparable year.

Long term loans were US$ 500,000 on the Reporting Date compared to US$ 1.1 million in the comparable year.

Financial Ratios	December 31, 2011	December 31, 2010
Current Ratio	1.4	0.8
Quick Ratio	1.1	0.4

As of the Reporting Date, the Company complies with bank covenants.

The company's special general meeting of shareholders held on February 16, 2011 approved to issue 3,550,000 ordinary shares of the Company (comprising 25.9% of the

Company's share capital following the issuance) at a price per each share of NIS 5.00, for a total consideration of NIS 17,750,000 to Risco Ltd., Israel, the Company's largest and controlling shareholder. The shares were issued to Risco Ltd. on March 14, 2011.

The Company's total equity as at the Reporting Date was US$ 2.4 million compared to deficit of US$3.5 million in the comparable year.

Cash Flow

During the Reporting Period, net cash used in operating activities was US$ 255,000 compared to US$ 2.6 million during the comparable Year.

During the Reporting Period, the Company provided US$1.8 million compared directed US$ 159 thousands, towards investment activities during the entire year of 2010.

Investment activities include proceeds from sales of investment in previously consolidated subsidiary in total amount of US$ 2.1 million.

During the Reporting Period, cash used in financing activities amounted to US$ 900,000, compared to US$ 1.5 million provided by financing activities during the fiscal year of 2010.

During the Year the Company repaid loans' principals in the amount of US$ 1.9 million.

3. Risks and Opportunities

Risks related to the Company

Dependence on Sub-contractors
The Company depends on sub-contractors in production and in research and development services. In the event that the relationship with any of the sub-contractors is terminated, the Company may incur a delay in developing new products and in producing and supplying its products until such time as the Company is able to locate and establish a relationship with alternative sub-contractor(s) or alternatively, perform such work in-house. Additional time would be needed before such new sub-contractor(s) or internal personnel could render effective development services and prepare production files previously provided by the original sub-contractor(s). This time delay could affect the Company's ability to producing products, launch new products or introduce new versions of products in a timely manner which could adversely affect the Company's market share. In addition, any arrangement with a new sub-contractor or a decision to perform any such work in-house may increase the Company's costs and affect its gross margins.

The Dependence on Integrators, Service Providers, Distributors and Installers of Systems
Currently, the Company does not typically sell its solutions to end users. The Company's traditional customers are integrators, service providers, distributors and installers of systems. Therefore, the Company is dependent, and has little control over, the customers who are, in fact, third-party installers of the Company's products. The Company has virtually no contact with end users of the product. The customers are responsible for the most part, for the sale, installation and technical support of the Company's products in relations to the end user. Due to this extended channel of distribution, the business results of the Company

could be significantly harmed through changes in the business conditions of the customers which are beyond the ability of the Company to control. Installation and/or service problems could arise that might affect the sale of products to end users and because the Company does not perform the installation or service of its products at the end user facility, it might be difficult for the Company to positively impact or resolve such issues between the customer and the end user. Furthermore, the Company may not be able to preserve its current relationships or to develop new relationships with different customers. Any such change in its relationships with customers is liable to significantly harm the business affairs of the Company, affect the Company's sales, its financial condition and business results.

Dependence on Key Customers

The Company's sales to its largest four customers accounted for approximately 49% of its total revenues during the year 2011 and approximately 43 % of its total revenues during 2010. The Company does not have long-term purchase contracts with its customers, and sales arrangements with some of these customers do not have minimum purchase requirements. The Company cannot assure that these major customers or any other customer will continue to purchase its products at all or in the same volumes or on the same terms as they have in the past. Their failure to do so may significantly reduce the Company's revenues.

Changes in Exchange Rates

At certain points in time, the financial statements can be exposed to fluctuations created due to the fact that some of the financial balances are linked to different currencies other than the U.S. dollar as opposed to the financial statements of the Company, which are denominated in U.S. dollars. In the event of depreciation in the U.S. dollar vis-à-vis other currencies, the Company will incur additional financial expenses, which would have a negative impact on the Company's operations and its financial condition. The Company endeavors to mitigate its exposure to such currency fluctuations by entering into transactions in different currencies with customers and suppliers.

In addition, the Company is exposed to exchange rate fluctuations between the U.S. dollar and other currencies, which may negatively affect its earnings. A substantial majority of the Company's revenues are denominated in U.S. dollars; however, a significant portion of the expenses associated with the Company's Israeli operations, including personnel, are incurred in NIS. The Company cannot predict any future trends in the exchange rates of the NIS against the U.S. dollar. In addition, exchange rate fluctuations in currency exchange rates in countries other than Israel where the Company operates may also negatively affect the Company's earnings. These currencies currently include the Euro and the British Pound.

The Company has established certain hedging policies to protect itself against the impact of currency fluctuations going forward.

Intellectual Property

Critical to the Company's future is the Company's ability to protect its proprietary technology. The Company relies on a combination of patent, copyright, trademark and trade secret laws in order to protect its intellectual property rights..

The process of seeking patent protection can be long, expensive and sometimes unsuccessful. Therefore, the Company has chosen to file for protection of its intellectual property in certain selected markets, although not in all markets in which the Company sells its products. There can be no assurance that the Company's pending or future patent applications will result in patents being issued or that the Company's existing patents or any future patents which may be granted will provide meaningful protection or commercial advantages to the Company. A patent only provides partial protection to intellectual property, as much depends on the climate of enforcement within the country granting the patent. In addition, any issued patent may be challenged, invalidated or legally (or illegally) circumvented by third parties, and the Company cannot be certain that its patents will be upheld as valid, be enforceable or prevent the development of competitive products. Moreover, the Company sells and markets its products in some countries; e.g., China, with potentially weak enforcement of intellectual property rights. If competitors are able to develop, manufacture and sell products that directly compete with the Company's products, the Company's sales and gross margins could be adversely affected.

In addition, competitors could purchase one of the Company's systems and attempt to replicate some or all of the competitive advantages the Company derives from its development efforts or design a product based on the Company's protected proprietary technology or develop their own competitive technologies that fall outside of the Company's protected intellectual property rights. If the Company's intellectual property is not adequately protected against use by competitors and other third parties, its competitive position could be eroded and its business could be adversely affected.

In addition to the risks of third-party infringement of the Company's intellectual property, there is also the risk that the Company may inadvertently and innocently infringe on the intellectual property of a third party, which would expose the Company to possible patent infringement claims which are often lengthy and costly disputes. The Company may be required to obtain licenses from third parties or otherwise redesign its products so as not to utilize such intellectual property, which may be uneconomical or otherwise impossible.

Risks Pertaining to Product Liability and Product Warranty The products developed by the Company may contain latent defects that may only be discovered after the products have been installed and are in use. Such defects could cause a reduction in customers' satisfaction, harm the reputation of the Company or create a need to introduce costly changes to the product. In addition, the Company could be exposed to potential product liability claims. This could involve significant costs to the Company. Although the Company has a Corporate General Liability insurance policy, this policy does not cover costs the Company may incur to change the product, and there is no guarantee that the Company's insurance policy will fully cover any and all types of claims pertaining to product liability or afford coverage to the full extent of such claims that may be filed against the Company.

The Company provides a limited product warranty for the use and operation of its products, many of which also contain components manufactured by third parties. In effect, the Company is warranting components which it does not manufacture. This could give rise to a situation whereby the Company provides a more extensive warranty on these third party components than the Company receives from such third party manufacturers, thus creating some warranty exposure for the Company.

Marketing and Product Risk

The Company spends significant time and money to understand the needs of the market; however, the Company may misjudge market needs. The Company may design products and solutions that do not meet market demands or are not priced correctly or are not delivered to the market in a timely manner. For example, the Company may develop complementary products for its security solution with remote management capabilities which the market deems not to be necessary. If this happens, the Company's costs would increase without a corresponding increase in revenues. This may have a negative impact on the Company's operations and its financial condition.

International Markets

The Company sells its products globally, primarily in Western Europe and Asia. As a result of operating internationally, the Company may face the following risks due to its international operations, any one of which may affect sales or the Company's profitability:

- Changes in governmental requirements and regulations and differences in various countries' requirements;
- Difficulty in collecting accounts receivables;
- Differences in customs in each country;
- Differences in taxation in different countries;
- Political and/or economic instability;
- Disruption in trade caused by civil disturbances and/or war;
- Local labor strikes that affect the Company's ability to sell or deliver products in a particular country; and
- Weakening economies in target markets.

Risk Related to the industry

Changes in Prices of Raw Materials

The raw materials of the Company (mainly electronic, metal and plastic components) are purchased from various suppliers throughout the world. The capacity, supply and demand for such raw materials is subject to cyclical forces and market factors as well and may fluctuate significantly and as a result, the Company may have limited ability to control its costs in securing raw materials. In addition, prices of raw materials may be subject to fluctuation. The Company cannot assure that it will be able to pass on to customers the increased costs associated with the procurement of raw materials. To the extent that increases in costs of raw materials cannot be passed on to customers or there is a delay in passing on the increased costs to customers, the Company is likely to absorb the increase in the cost of raw materials which may materially reduce its margin of profitability.

Delay or Discontinuation in the Supply Finished products

Currently, the Company receives sales forecasts from the majority of its customers. Based on these sales forecasts and incoming orders, the Company purchases finished goods from it subcontractors needed for sale. The Company generally maintains a sufficient inventory of long lead-time items in order to meet its sales forecasts schedule.

The Company may choose to maintain inventories of products that exceed what is necessary for the short term in order to have a small buffer stock to compensate for shortages or cessation in the supply of components. In such an event, the Company will incur additional costs to maintain this excess inventory, which could affect its gross margins.

Competition and Pressure to Develop New Products

The Company operates in a competitive market environment. Competition, whether direct or indirect, may adversely affect the income and profits of the Company through pressure exerted on prices, the loss of market share or other factors. Some of the Company's current and potential competitors are large companies or conglomerates that have vast resources (including capabilities in the fields of finance, technology, production, marketing and distribution), including, for example, UTC , Tyco, Bosch and Honeywell.

In addition, new competitors, such as service providers, utility companies, cable companies, and non-security distributors, may enter into the competitive market in which the Company operates.

The Company's products deal with evolving technology. The Company must continually invest in product development in order to stay on the cutting edge of technology in its market and secure its market position. The Company's sales may be affected by newer technologies offered by competitors that are not available from the Company.

Risks Related to Israel

Chief Scientist

Certain of the Company's products are developed using financing, in part, provided by the Chief Scientist of the Israel Ministry of Industry and Trade (the "Chief Scientist"), who is responsible for implementing the Israeli government's policy regarding the support and encouragement of industrial research and development.

The participation of the Chief Scientist in R&D expenses is based on certain conditions, unless the Chief Scientist approves a different arrangement .In the event the Company does not comply with the terms of the Chief Scientist grants, the Company may be required to return the grants, which may have a material adverse effect on the Company.

Security, Political and Economic Instability in Israel The principal offices of the Company are located in Israel. Accordingly, security, political and economic conditions in Israel may directly affect the Company's business. Over the past several decades, a number of armed conflicts have occurred between Israel and its Arab neighbors. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could adversely affect the Company's operations. Since October 2000, terrorist violence in Israel increased significantly, primarily in the West Bank and Gaza Strip. Thus far in 2005, there has been a noticeable decline in terrorist activity. Israel's recent unilateral withdrawal from the Gaza Strip has stimulated the local economy and opened potential contacts with countries which had no previous diplomatic contact with Israel. However, the ongoing hostilities and violence, future armed conflicts, political developments in other countries in the region or continued or increased terrorism, could disrupt the Company's operations or make conducting the Company's operations in Israel more difficult. Any of these factors could have the effect of increasing the Company's costs, adversely affecting the Company's financial results and the expansion of the Company's business and delaying deliveries to Customers.

Furthermore, several countries continue to restrict business with Israel, in general, and with Israeli companies, in particular, and this may limit the Company's ability to make sales to these countries. These boycotts and embargos may have an adverse impact on the operations, financial condition or the further expansion of the Company's business.

4. Events after the end of the reporting period

No material events have occurred since the end of the reporting period on December 31, 2011.

5. Information on the stock

The issued share capital of the company is NIS 68,564,240 and consists of 13,712,848 ordinary shares at NIS 5.00 par value each. All shares have the same voting rights and dividend claims.

There are no shares in the company with special rights according rights of control.

Under the provisions of German securities trading legislation, every investor whose proportion of the voting rights in the company reaches, exceeds or falls below certain thresholds as a result of the purchase or sale of shares or in any other way must notify the company and the Federal Financial Supervisory Authority (BaFin) thereof. The lowest threshold for such disclosures is 3%. Risco Ltd. currently holds more than 50% of the Company's share capital.

Restrictions on the voting rights of shares could result from statutory provisions. The Company's Board of Directors is not aware of any other restrictions on the exercise of voting rights or the transfer of shares.

On June 14, 2011, the Company's audit committee and Board of Directors approved the allocation of 330,000 share options to the Company's CEO, directors and top management of Risco Ltd. The option grant was subject to the approval of the meeting of the Company's shareholders. The approval was received on October 10, 2011. The options granted will expire ten years after the date of grant and vest over a period of three years. The exercise price of the options granted is EUR 1.50.

The Company's shares are listed in the Regulated Market/Prime Standard segment of the Frankfurt Stock exchange.

6. Outlook

Future Projections

Looking forward, the Company expects an increase in revenues from its strategic markets, in particular, Northern and Western Europe. In these locations, the Company intends to address non-traditional marketing channels, in addition to the traditional security channels.

Recently, the Company has entered into a distribution agreements with a leading central monitoring station service provider ("CMS") in Poland and a leading security service provider for supplying residential security solutions for the Italian market. The agreements cover the distribution of the Company's innovative wireless security, safety, connectivity and control systems such as the iConnect and CommPact solutions and appending peripheral products.

In addition, the Company has signed a distribution agreement with Risco Ltd. and its subsidiaries, which will broaden the Company's marketing and sales as well as logistic global coverage.

The Company plans to focus on its 2-way-wireless iConnect product line and its PIR Camera Detector with a built-in camera for video verification, which will support a wide range of solutions and services that the Company offers to its customers. The Company believes that the new solution will be well received in the market place.

Among its goals, the Company will also continue its efforts to obtain and maintain international standard approvals for its products.

After taking into consideration last year's sale of its UK subsidiary, which accounted for a sales volume of around US$ 6 million in 2011, the successful implementation of new sales teams in the UK and for several other European markets, as well as the recent change in the Scandinavian market, where a long-term customer relationship was discontinued because of a recent M&A transaction of the client, EL expects 2012 sales to reach at least US$ 20 million.

In view of the recent success in gaining new customers for the Company's two-way wireless iConnect and CommPact systems for the residential and small commercial markets, the Company at the moment realistically expects to achieve a positive net result for the current fiscal year.

Responsibility Statement

To the best of our knowledge and in accordance with the applicable reporting principles for financial reporting, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company, and the management report of the Company includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal opportunities and risks associated with the expected development of the Company for the remaining months of the financial year.

Douglas Luscombe	Moshe Alkelai
CEO	Chairman of the Board

Rishon Le Zion, March 31, 2012

ELECTRONICS LINE 3000 LTD.

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2011

U.S. DOLLARS IN THOUSANDS

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of

ELECTRONICS LINE 3000 LTD.

We have audited the accompanying consolidated financial statements of Electronics Line 3000 Ltd. and its subsidiaries ("the Group"), which comprise the consolidated statements of financial position as of December 31, 2011 and 2010, and the consolidated income statements, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the two years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from 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 auditors' 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 auditors consider 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of 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 present fairly, in all material respects the financial position of the Group as of December 31, 2011 and 2010, and of its financial performance and its cash flows for each of the two years then ended, in accordance with International Financial Reporting Standards.

Tel-Aviv, Israel
March 21, 2012

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

U.S. dollars in thousands

		December 31,	
	Note	**2011**	**2010**
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	3	1,687	983
Trade receivables	4	2,017	2,970
Other accounts receivable	5	1,912	*) 1,484
Inventories	6	1,423	5,494
Total current assets		7,039	10,931
NON-CURRENT ASSETS:			
Property, plant and equipment:	7		
Cost		13,858	15,907
Less - accumulated depreciation		13,334	13,920
Property, plant and equipment, net		524	1,987
Intangible assets	8	403	504
Deferred taxes	14e	483	*) 491
Security deposits		80	97
Total non-current assets		1,490	3,079
Total assets		8,529	14,010

*) Reclassified, see note 2y.

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

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

U.S. dollars in thousands

	Note	December 31, 2011	December 31, 2010
LIABILITIES AND EQUITY			
CURRENT LIABILITIES:			
Short-term credit from banks	9	1,244	3,517
Short-term credit from related parties	26	-	3,817
Trade payables	10	2,796	5,024
Income taxes payable		-	149
Other current liabilities	11	925	2,162
Total current liabilities		4,965	14,669
NON-CURRENT LIABILITIES:			
Loans from banks	12	527	1,065
Employee benefit liabilities, net	13	140	165
Other long-term liabilities	15c	426	1,201
Deferred taxes	14e	-	379
Total non-current liabilities		1,093	2,810
EQUITY:	16		
Share capital		15,933	10,933
Additional paid-in capital		6,474	6,453
Foreign currency translation reserve		-	1,413
Accumulated deficit		(19,936)	(22,268)
Total equity		2,471	(3,469)
Total liabilities and equity		8,529	14,010

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

March 21, 2012			
Date of approval of the financial statements	Moshe Alkelai Chairman of the Board	Douglas Luscombe President and CEO	Lior Meidan Director

CONSOLIDATED INCOME STATEMENTS

U.S. dollars in thousands, except per share data

	Note	Year ended December 31, 2011	Year ended December 31, 2010
Revenues	18	24,164	26,717
Cost of revenues	19	15,745	18,338
Gross profit		8,419	8,379
Operating costs and expenses:			
Research and development	20	1,733	1,884
Selling and marketing	21	2,878	3,840
General and administrative	22	1,977	3,167
Other expenses, net	23	315	4,450
Total operating costs and expenses		6,903	13,341
Operating profit (loss)		1,516	(4,962)
Financial income	24a	51	62
Financial expenses	24b	405	428
Gain from sale of subsidiary	28	1,224	-
Income (loss) before taxes on income		2,386	(5,328)
Taxes on income	14b	54	523
Net Profit (loss)		2,332	(5,851)
Net profit (loss) per share (basic and diluted)	25	0.18	(0.58)

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

U.S. dollars in thousands

	Year ended December 31,	
	2011	**2010**
Net income (loss)	2,332	(5,851)
Other comprehensive income (loss):		
Adjustments arising from translating financial statements of foreign operations	(6)	(175)
Amounts transferred to the income statement for sale of foreign operation	(1,407)	-
Loss on cash flow hedges	-	(10)
Total other comprehensive income (loss)	(1,413)	(185)
Total comprehensive income (loss)	919	(6,036)

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
U.S. dollars in thousands

	Share capital	Additional paid-in capital	Foreign currency translation reserve	Hedge reserves	Accumulated deficit	Total equity
Balance as of January 1, 2010	10,933	6,621	1,588	10	(16,417)	2,735
Loss	-	-	-	-	(5,851)	(5,851)
Other comprehensive loss:						
Financial statements of foreign operations	-	-	(175)	-	-	(175)
Loss on cash flow hedges	-	-	-	(10)	-	(10)
Total other comprehensive loss			(175)	(10)	-	(185)
Total comprehensive loss	-	-	(175)	(10)	(5,851)	(6,036)
Cost of share-based payments	-	(168)	-	-	-	(168)
Balance as of January 1, 2011	10,933	6,453	1,413	-	(22,268)	(3,469)
Net income	-	-	-	-	2,332	2,332
Other comprehensive income:						
Financial statements of foreign operations	-	-	(6)	-	-	(6)
Amounts transferred to the income statement for sale of foreign operation	-	-	(1,407)	-	-	(1,407)
Total other comprehensive loss	-	-	(1,413)	-	-	(1,413)
Total comprehensive income	-	-	(1,413)	-	2,332	919
Issuance of share capital	5,000	-	-	-	-	5,000
Cost of share-based payments	-	21	-	-	-	21
Balance as of December 31, 2011	15,933	6,474	-	-	(19,936)	2,471

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,	
	2011	**2010**
Cash flows from operating activities:		
Net profit (loss)	2,332	(5,851)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Adjustments to profit or loss items:		
Depreciation and amortization	480	3,153
Loss (gain) from sale of property, plant and equipment	(28)	7
Decrease in employee benefit liabilities, net	(99)	(156)
Cost of share-based payments	21	(168)
Taxes on income	54	523
Financial expenses, net	384	368
Gain from sale of subsidiary	(1,224)	-
	(412)	3,727
Changes in operating asset and liability items:		
Increase in trade receivables	(1,033)	(98)
Increase in other accounts receivable	(813)	(715)
Decrease (increase) in inventories	2,081	(1,019)
Decrease (increase) in security deposits	17	(23)
Increase (decrease) in trade payables	(396)	1,012
Increase (decrease) in other long-term liabilities	(775)	1,201
Decrease in other current liabilities	(859)	(262)
	(1,778)	96
Interest paid	(384)	(368)
Income taxes paid	(13)	(161)
	(397)	(529)
Net cash used in operating activities	(255)	(2,557)
Cash flows from investing activities:		
Investment in intangible assets	-	(112)
Acquisition of property, plant and equipment	(315)	(120)
Proceeds from sale of equipment	62	73
Proceeds from sale of investments in previously consolidated subsidiaries (a)	2,091	-
Net cash Provided (used) in investing activities	1,838	(159)

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31, 2011	Year ended December 31, 2010
Cash flows from financing activities:		
Increase (decrease) in short-term bank credit, net	(1,243)	117
Receipt of long-term loans from banks	1,054	-
Receipt of short-term loans from related parties	1,183	3,817
Repayment of long-term loans from related parties	-	(140)
Repayment of long-term loans from banks	(1,865)	(2,260)
Net cash provided by (used in) financing activities	(871)	1,534
Exchange differences on balances of cash and cash equivalents of foreign operations	(8)	(80)
Increase (decrease) in cash and cash equivalents	704	(1,262)
Cash and cash equivalents at beginning of year	983	2,245
Cash and cash equivalents at end of year	1,687	983
Significant non-cash transactions:		
Conversion of shareholders' debt into shares	5,000	-

(a) Proceeds from sale of investments in previously consolidated subsidiaries:

The subsidiaries' assets and liabilities at date of sale:

	2011	2010
Working capital (excluding cash and cash equivalents)	2,024	-
Property, plant and equipment	1,379	-
Deferred taxes	(349)	-
Non-current liabilities	(780)	-
Amounts transferred to the income statement for sale of foreign operation	(1,407)	-
Gain from sale of subsidiaries	1,224	-
	2,091	-

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

NOTE 1:- GENERAL

a. Electronics Line 3000 Ltd. ("the Company") was incorporated in Israel in December 2002.

The Company's shares are publicly traded on the Prime Standard, a market operated by the Frankfurt Stock Exchange.

b. The Company and its subsidiaries ("the Group") are engaged in the design, development, production, marketing and sale of electronic security with remote management solutions, and complementary products for the mass residential and small commercial markets. These solutions can be monitored and enable remote management of the premises for security, and automation and video application. The registered office of the Group is located at 14 Hachoma Street, Rishon LeZion, Israel

c. Definitions:

In these financial statements:

The Company	-	Electronics Line 3000 Ltd.
The Group	-	The Company and its investees, as detailed in the accompanying appendix.
Subsidiaries	-	Companies that are controlled by the Company (as defined in IAS 27(2008)) and whose accounts are consolidated with those of the Company.
Investees	-	Subsidiaries.
Related parties	-	As defined in IAS 24.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. Basis of presentation of the financial statements:

1. Measurement basis:

The Company's financial statements have been prepared on a cost basis, except for the following:

Deferred tax assets;
Employee benefit assets and employee benefit liabilities.

The Company has elected to present the statement of comprehensive income using the function of expense method.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

2. Basis of preparation of the financial statements:

   These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These Standards comprise:

   a) International Financial Reporting Standards (IFRS).
   b) International Accounting Standards (IAS).
   c) Interpretations issued by the IFRIC and by the SIC.

3. Consistent accounting policies:

   The accounting policies adopted in the financial statements are consistent with those of all periods presented.

4. Changes in accounting policies in view of the adoption of new standards:

   IAS 1 - Presentation of Financial Statements:

   According to the amendment to IAS 1 ("the Amendment"), the changes between the opening and the closing balances of each component of other comprehensive income may be presented in the statement of changes in equity or in the notes accompanying the annual financial statements. Accordingly, the Company has elected to present this disclosure in the statement of changes in equity. The Amendment has been applied retrospectively from January 1, 2011.

   24 - Related Party Disclosures:

   The amendment to IAS 24 ("the Amendment") clarifies the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in its application. The Amendment has been applied retrospectively from January 1, 2011.

   The required disclosures have been included in the Company's financial statements.

   IFRS 7 - Financial Instruments: Disclosure:

   The amendment to IFRS 7 ("the Amendment") clarifies the Standard's disclosure requirements. In this context, emphasis is placed on the interaction between the quantitative disclosures and the qualitative disclosures and the nature and extent of risks arising from financial instruments. The Amendment also reduces the disclosure requirements for collateral held by the Company and revises the disclosure requirements for credit risk. The Amendment has been applied retrospectively commencing from the financial statements for periods beginning on January 1, 2011.

   The retrospective application of the Amendment did not have a material effect on the Company's financial statements.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

b. Significant estimates and assumptions used in the preparation of the financial statements:

- Judgments:

  In the process of applying the significant accounting policies, the Group has made the following judgments which have the most significant effect on the amounts recognized in the financial statements:

- Determining the fair value of share-based payment transactions:

  The fair value of share-based payment transactions is determined using an acceptable option-pricing model. The assumptions used in the model can include the share price, exercise price, expected volatility, expected life, expected dividend and risk-free interest rate.

- Estimates and assumptions:

  The preparation of the financial statements requires management to make estimates and assumptions that have an effect on the application of the accounting policies and on the reported amounts of assets, liabilities, revenues and expenses. These estimates and underlying assumptions are reviewed regularly. Changes in accounting estimates are reported in the period of the change in estimate.

  The key assumptions made in the financial statements concerning uncertainties at the end of the reporting period and the critical estimates computed by the Group that may result in a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

- Legal claims:

  In estimating the likelihood of outcome of legal claims filed against the Company and its investees, the companies rely on the opinion of their legal counsel. These estimates are based on the legal counsel's best professional judgment, taking into account the stage of proceedings and historical legal precedents in respect of the different issues. Since the outcome of the claims will be determined in courts, the results could differ from these estimates.

- Deferred tax assets:

  Deferred tax assets are recognized for unused carryforward tax losses and temporary differences to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- Pensions and other post-employment benefits:

  The liability in respect of post-employment defined benefit plans is determined using actuarial valuations. The actuarial valuation involves making assumptions about, among others, discount rates, expected rates of return on assets, future salary increases and mortality rates. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty.

- Development costs:

  Development costs are capitalized in accordance with the accounting policy as described in m below. In testing for impairment, management makes assumptions regarding the expected cash flows from the asset being developed, the discount rate and the expected period of benefits. Further details are given in Note 8.

c. Consolidated financial statements:

The consolidated financial statements comprise the financial statements of companies that are controlled by the Company (subsidiaries). Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity. The effect of potential voting rights that are exercisable at the end of the reporting period is considered when assessing whether an entity has control. The consolidation of the financial statements commences on the date on which control is obtained and ends when such control ceases.

Significant intragroup balances and transactions and gains or losses resulting from intragroup transactions are eliminated in full in the consolidated financial statements.

Upon the disposal of a subsidiary resulting in loss of control, the Company:

- derecognizes the subsidiary's assets (including goodwill) and liabilities.
- derecognizes the carrying amount of non-controlling interests.
- recognizes the fair value of the consideration received.
- regarding loss of control on or after January 1, 2010, recognizes any remaining equity interest at fair value.
- regarding loss of control through December 31, 2009, the portion of the investment sold is derecognized with recognition of the resulting gain or loss and any remaining investment is accounted for either by the equity method (IAS 28), as a company under common control (IAS 31) or as a financial asset (IAS 39), as applicable.
- recognizes any resulting difference (surplus or deficit) as gain or loss.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- regarding loss of control on or after January 1, 2010, reclassifies the components recognized in other comprehensive income on the same basis as would be required if the subsidiary had directly disposed of the related assets or liabilities. Accordingly, cumulative exchange differences are reclassified to profit or loss upon loss of control.
- regarding loss of control through December 31, 2009, only the proportionate share of cumulative exchange differences that is disposed of is reclassified to profit or loss.

The financial statements of the Company and of the subsidiaries are prepared as of the same dates and periods. The consolidated financial statements are prepared using uniform accounting policies by all companies in the Group.

d. Functional currency, presentation currency and foreign currency:

1. Functional currency and presentation currency:

The presentation currency of the financial statements is the U.S. dollar.

The functional currency, which is the currency that best reflects the economic environment in which the Company operates and conducts its transactions, is separately determined for each Group entity, and is used to measure its financial position and operating results. The functional currency of the Company is the U.S. dollar.

The financial statements of a subsidiary have been translated from the functional currency (GBP) to the presentation currency (U.S. dollar), in accordance with the following:

a) Assets and liabilities at the end of each reporting period (including comparative data) are translated at the closing rate at the end of the reporting period. Goodwill and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation are treated as assets and liabilities of the foreign operation and are translated at the closing rate at the end of the reporting period.

b) Income and expenses for each period presented in the statement of income (including comparative data) are translated at average exchange rates for the presented periods; however, if exchange rates fluctuate significantly, income and expenses are translated at the exchange rates at the date of the transactions.

c) Share capital, capital reserves and other changes in capital are translated at the exchange rate prevailing at the date of incurrence.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

d) Retained earnings are translated based on the opening balance translated at the exchange rate at that date and other relevant transactions (such as dividend) during the period are translated as described in b) and c) above.

e) All resulting translation differences are recognized as a separate component of other comprehensive income (loss) in equity "foreign currency translation reserve".

On a total or partial disposal of a foreign operation, the relevant part of the other comprehensive income (loss) is recognized in the statement of income.

Intragroup loans for which settlement is neither planned nor likely to occur in the foreseeable future are, in substance, a part of the investment in that foreign operation and are accounted for as part of the investment and the exchange differences arising on these loans (net of their tax effect) are recognized in the same component of equity as discussed in e) above.

2. Transactions, assets and liabilities in foreign currency:

Transactions denominated in foreign currency (other than the functional currency) are recorded on initial recognition at the exchange rate at the date of the transaction. After initial recognition, monetary assets and liabilities denominated in foreign currency are translated at the end of each reporting period into the functional currency at the exchange rate at that date. Exchange differences, other than those capitalized to qualifying assets or carried to equity in hedging transactions, are recognized in the statement of income. Non-monetary assets and liabilities measured at cost are translated at the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currency and measured at fair value are translated into the functional currency using the exchange rate prevailing at the date when the fair value was determined.

3. Index-linked monetary items:

Monetary assets and liabilities linked to the changes in the Israeli Consumer Price Index ("Israeli CPI") are adjusted at the relevant index at the end of each reporting period according to the terms of the agreement. Linkage differences arising from the adjustment, as above, other than those capitalized to qualifying assets or carried to equity in hedge transactions, are recognized in the statement of income.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

e. Cash equivalents:

Cash equivalents are considered as highly liquid investments, including unrestricted short-term bank deposits with an original maturity of three months or less from the date of acquisition or with a maturity of more than three months, but which are redeemable on demand without penalty and which form part of the Group's cash management.

f. Short-term deposits:

Short-term bank deposits are deposits with an original maturity of more than three months from the date of acquisition. The deposits are presented according to their terms of deposit.

g. Allowance for doubtful accounts:

The allowance for doubtful accounts is determined in respect of specific debts whose collection, in the opinion of the Company's management, is doubtful. The Company also recognizes a provision for groups of customers that are collectively assessed for impairment based on their credit risk characteristics. Impaired debts are derecognized when they are assessed as uncollectible.

h. Inventories:

Inventories are measured at the lower of cost and net realizable value. The cost of inventories comprises costs of purchase and costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated selling costs.

Cost of inventories is assigned as follows:

Finished products - cost of direct materials and labor and a proportion of manufacturing overheads, based on normal operating capacity but excluding borrowing costs.

The Company periodically evaluates the condition and age of inventories and makes provisions for slow-moving inventories accordingly.

If in a particular period production is not at normal capacity, the cost of inventories does not include additional fixed overheads in excess of those allocated based on normal capacity. Such unallocated overheads are recognized as an expense in the statement of income in the period in which they are incurred. Furthermore, cost of inventories does not include abnormal amounts of materials, labor or other costs resulting from inefficiency.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

i. Financial instruments:

1. Financial assets:

Financial assets within the scope of IAS 39 are initially recognized at fair value plus directly attributable transaction costs, except for investments at fair value through profit or loss in respect of which transaction costs are recorded in profit or loss.

After initial recognition, the accounting treatment of investments in financial assets is based on their classification into one of the following four categories:

- financial assets at fair value through profit or loss;
- held-to-maturity investments;
- loans and receivables; and
- available-for-sale financial assets.

a) Financial assets at fair value through profit or loss:

The Group has financial assets at fair value through profit or loss comprising financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss.

Financial assets are classified as held for trading if they are acquired principally for the purpose of selling or repurchasing in the near term, if they form part of a portfolio of identified financial instruments that are managed together to earn short-term profits or if they are derivatives not designated as hedging instruments. Gains or losses on investments held for trading are recognized in profit or loss when incurred.

b) Loans and receivables:

The Group has loans and receivables that are financial assets (non-derivative) with fixed or determinable payments that are not quoted in an active market. After initial recognition, loans are measured based on their terms at amortized cost using the effective interest method taking into account directly attributable transaction costs. Short-term receivables (such as trade and other receivables) are measured based on their terms, normally at face value. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the systematic amortization process.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

2. Financial liabilities:

a) Financial liabilities measured at amortized cost:

Interest- bearing loans and borrowings are initially recognized at fair value less directly attributable transaction costs (such as loan raising costs). After initial recognition, loans, are measured based on their terms at amortized cost using the effective interest method taking into account directly attributable transaction costs. Short-term borrowings (such as trade and other payables) are measured based on their terms, normally at face value. Gains and losses are recognized in the statement of income when the financial liability is derecognized as well as through the systematic amortization process.

b) Financial liabilities at fair value through profit or loss:

Financial liabilities at fair value through profit or loss include financial liabilities classified as held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

3. Fair value:

The fair value of financial instruments that are actively traded in organized financial markets is determined by reference to market prices at the end of the reporting period. For financial instruments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow or other valuation models.

4. Offsetting financial instruments:

Financial assets and financial liabilities are offset and the net amount is presented in the statement of financial position if there is a legally enforceable right to set off the recognized amounts and there is an intention either to settle on a net basis or to realize the asset and settle the liability simultaneously.

5. Derecognition of financial instruments:

a) Financial assets:

A financial asset is derecognized when the contractual rights to the cash flows from the financial asset expire or the Company has transferred its contractual rights to receive cash flows from the financial asset or assumes an obligation to pay the cash flows in full without material delay to a third party and has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

A transaction involving factoring of accounts receivable is derecognized when the abovementioned conditions are met.

If the Company transfers its rights to receive cash flows from an asset and neither transfers nor retains substantially all the risks and rewards of the asset nor transfers control of the asset, a new asset is recognized to the extent of the Company's continuing involvement in the asset. When continuing involvement takes the form of guaranteeing the transferred asset, the extent of the continuing involvement is the lower of the original carrying amount of the asset and the maximum amount of consideration received that the Company could be required to repay.

b) Financial liabilities:

A financial liability is derecognized when it is extinguished, which is when the obligation is discharged or cancelled or expires. A financial liability is extinguished when the debtor (the Group):

- discharges the liability by paying in cash, other financial assets, goods or services; or
- is legally released from the liability.

Where an existing financial liability is exchanged with another liability from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is accounted for as an extinguishment of the original liability and the recognition of a new liability. The difference between the carrying amount of the above liabilities is recognized in the statement of income. If the exchange or modification is immaterial, it is accounted for as a change in the terms of the original liability and no gain or loss is recognized from the exchange.

6. Impairment of financial assets:

The Group assesses at the end of each reporting period whether there is any objective evidence that the following financial asset or group of financial assets is impaired.

Financial assets carried at amortized cost:

There is objective evidence of impairment of debt instruments and loans and receivables carried at amortized cost as a result of one or more events that has occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows. Evidence of impairment may include indications that the debtor is experiencing financial difficulties, including liquidity difficulty and default in interest or principal payments.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The amount of the loss recorded in statement of income is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not yet been incurred) discounted at the financial asset's original effective interest rate (the effective interest rate computed at initial recognition). If the financial asset has a variable interest rate, the discount rate is the current effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account (see allowance for doubtful accounts above). In a subsequent period, the amount of the impairment loss is reversed if the recovery of the asset can be related objectively to an event occurring after the impairment was recognized. The amount of the reversal, up to the amount of any previous impairment, is recorded in statement of income.

j. Property, plant and equipment:

Items of property, plant and equipment are measured at cost with the addition of direct acquisition costs, less accumulated depreciation, less accumulated impairment losses and less related investment grants and excluding day-to-day servicing expenses. Cost includes spare parts and auxiliary equipment that can be used only in connection with the machinery and equipment.

Depreciation is calculated on a straight-line basis over the useful life of the assets at annual rates as follows:

	%	Mainly %
Buildings	2	2
Machinery and equipment	10 - 15	10
Motor vehicles	15	15
Office furniture and equipment	6 - 33	33
Leasehold improvements	see below	

Leasehold improvements are depreciated on a straight-line basis over the shorter of the lease term (including the extension option held by the Group and intended to be exercised) and the expected life of the improvement.

A part of a fixed asset with a cost that is significant in relation to the total cost of the item is depreciated separately using the component method. Depreciation is calculated on a straight-line basis at annual rates that are adequate for the depreciation of the assets over the term of their expected useful life.

The useful life, depreciation method and residual value of an asset are reviewed at least each year-end and the changes are accounted for as a prospective change in accounting estimate. As for testing the impairment of property, plant and equipment, see m below.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognized. An asset is derecognized on disposal or when no further economic benefits are expected from its use. The gain or loss arising from the derecognition of the asset (determined as the difference between the net disposal proceeds and the carrying amount in the financial statements) is included in the statement of income when the asset is derecognized.

k. Intangible assets:

Separately acquired intangible assets are measured on initial recognition at cost including directly attributable costs. Intangible assets acquired in a business combination are included at fair value at the acquisition date. After initial recognition, intangible assets are carried at their cost less any accumulated amortization and any accumulated impairment losses. Expenditures relating to internally generated intangible assets, excluding capitalized development costs, are recognized in statement of income when incurred.

After initial recognition, intangible assets are carried at their cost less any accumulated amortization and any accumulated impairment losses.

According to management's assessment, intangible assets have a finite useful life. The assets are amortized over their useful life using the straight-line method and reviewed for impairment whenever there is an indication that the asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are 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 prospectively as changes in accounting estimates. The amortization of intangible assets with finite useful lives is recognized in statement of income.

The useful life of intangible assets is as follows:

	Years
Product files	5

Gains or losses arising from the derecognition of an intangible asset are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in statement of income.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Research and development expenses:

Research expenditures are recognized in statement of income when incurred. An intangible asset arising from development or from the development phase of an internal project is recognized if the Company can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale; the Company's intention to complete the intangible asset and use or sell it; the Company's ability to use or sell the intangible asset; how the intangible asset will generate future economic benefits; the availability of adequate technical, financial and other resources to complete the intangible asset; and the Company's ability to measure reliably the expenditure attributable to the intangible asset during its development.

The asset is measured at cost less any accumulated amortization and any accumulated impairment losses. Amortization of the asset begins when development is complete and the asset is available for use. As for the testing of impairment, see m below.

l. Impairment of non-financial assets:

The Company evaluates the need to record an impairment of the carrying amount of non-financial assets (property, plant and equipment, and intangible assets) whenever events or changes in circumstances indicate that the carrying amount is not recoverable. If the carrying amount of non-financial assets exceeds their recoverable amount, the assets are reduced to their recoverable amount. The recoverable amount is the higher of fair value less costs of sale and value in use. In measuring value in use, the expected future cash flows are discounted using a pre-tax discount rate that reflects the risks specific to the asset. The recoverable amount of an asset that does not generate independent cash flows is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in statement of income.

An impairment loss of an asset, other than goodwill, is reversed only if there have been changes in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. Reversal of an impairment loss, as above, shall not be increased above the lower of the carrying amount that would have been determined (net of depreciation or amortization) had no impairment loss been recognized for the asset in prior years and its recoverable amount. The reversal of impairment loss of an asset presented at cost is recognized in profit or loss. A reversal of an impairment loss on a revalued asset is recognized in other comprehensive income. However, to the extent that an impairment loss on the same revalued asset was previously recognized in statement of income, a reversal of that impairment loss is also recognized in statement of income.

The following criteria are applied in assessing impairment of these specific assets:

Development costs capitalized during the development period:

The impairment test is performed annually, on December 31, or more frequently if events or changes in circumstances indicate that there is an impairment.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

m. Government grants:

Government grants are recognized when there is reasonable assurance that the grants will be received and the Company will comply with the attached conditions. Government investment grants related to assets, such as property, plant and equipment, are presented as a deduction from the carrying amount of the assets.

Government grants received from the Office of the Chief Scientist ("OCI") as support for a research and development project which grants include an obligation to pay to the State royalties that are conditional on future sales arising from the project, are recognized upon receipt as a liability if future economic benefits are expected from the project that will result in royalty-bearing sales. If no such economic benefits are expected, the grants are recognized as a reduction of the related research and development expenses. In that event, the royalty obligation is treated as contingent liability in accordance with IAS 37.

At the end of each reporting period, the Company evaluates, based on its best estimate of future sales, whether there is reasonable assurance that the liability recognized, in whole or in part, will not be repaid (since the Company will not be required to pay royalties). If there is such reasonable assurance, the appropriate amount of the liability is derecognized and recorded in profit or loss as a reduction of research and development expenses. If the estimate of future sales indicates that there is no such reasonable assurance, the appropriate amount of the liability that reflects expected future royalty payments is recognized with a corresponding adjustment to research and development expenses.

n. Taxes on income:

Taxes on income in the statement of income comprise current and deferred taxes. Current or deferred taxes are recognized in the statement of income except to the extent that the tax arises from items which are recognized directly in other comprehensive income or in equity. In such cases, the tax effect is also recognized in the relevant item.

1. Current taxes:

   IAS 12.46:

   The current tax liability is measured using the tax rates and tax laws that have been enacted or substantively enacted by the end of reporting period as well as adjustments required in connection with the tax liability in respect of previous years.

2. Deferred taxes:

   Deferred taxes are computed in respect of temporary differences between the carrying amounts in the financial statements and the amounts attributed for tax purposes.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Deferred taxes are measured at the tax rates that are expected to apply to the period when the taxes are reversed in statement of income, comprehensive income or equity, based on tax laws that have been enacted or substantively enacted by the end of the reporting period. Deferred taxes in statement of income represent the changes in the carrying amount of deferred tax balances during the reporting period, excluding changes attributable to items recognized outside of profit or loss.

Deferred tax assets are reviewed at the end of each reporting period and reduced to the extent that it is not probable that they will be utilized. Also, temporary differences (such as carryforward losses) for which deferred tax assets have not been recognized are reassessed and deferred tax assets are recognized to the extent that their recoverability has become probable. Any resulting reduction or reversal is recognized in the line item, "taxes on income".

Taxes that would apply in the event of the disposal of investments in investees have not been taken into account in computing deferred taxes, as long as the disposal of the investments in investees is not probable in the foreseeable future. Also, deferred taxes that would apply in the event of distribution of earnings by investees as dividends have not been taken into account in computing deferred taxes, since the distribution of dividends does not involve an additional tax liability or since it is the Company's policy not to initiate distribution of dividends that triggers an additional tax liability.

All deferred tax assets and deferred tax liabilities are presented in the statement of financial position as non-current assets and non-current liabilities, respectively. Deferred taxes are offset in the statement of financial position if there is a legally enforceable right to offset a current tax asset against a current tax liability and the deferred taxes relate to the same taxpayer and the same taxation authority.

o. Share-based payment transactions:

The Company's employees are entitled to remuneration in the form of equity-settled share-based payment transactions.

Equity-settled transactions:

The cost of equity-settled transactions with employees is measured at the fair value of the equity instruments granted at grant date. The fair value is determined using a standard option pricing model, additional details are given in Note 16. In estimating fair value, the vesting conditions (consisting of service conditions and performance conditions other than market conditions) are not taken into account. The only conditions taken into account in estimating fair value are market conditions and non-vesting conditions.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The cost of equity-settled transactions is recognized in profit or loss, together with a corresponding increase in equity, during the period which the performance and/or service conditions are to be satisfied, ending on the date on which the relevant employees become fully entitled to the award ("the vesting period"). The cumulative expense recognized for equity-settled transactions at the end of each reporting period until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The expense or income recognized in profit or loss represents the movement in the cumulative expense recognized at the end of the reporting period.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether the market condition is satisfied, provided that all other vesting conditions (service and/or performance) are satisfied.

If the Company modifies the conditions on which equity-instruments were granted, an additional expense is recognized for any modification that increases the total fair value of the share-based payment arrangement or is otherwise beneficial to the employee at the modification date.

If a grant of an equity instrument is cancelled, it is accounted for as if it had vested on the cancellation date, and any expense not yet recognized for the grant is recognized immediately. However, if a new grant replaces the cancelled grant and is identified as a replacement grant on the grant date, the cancelled and new grants are accounted for as a modification of the original grant, as described in the previous paragraph.

p. Employee benefit liabilities:

The Group has several employee benefit plans:

1. Short-term employee benefits:

Short-term employee benefits include salaries, paid annual leave, paid sick leave, recreation and social security contributions and are recognized as expenses as the services are rendered. A liability in respect of a cash bonus or a profit-sharing plan is recognized when the Group has a legal or constructive obligation to make such payment as a result of past service rendered by an employee and a reliable estimate of the amount can be made.

2. Post-employment benefits:

The plans are normally financed by contributions to insurance companies and classified as defined contribution plans or as defined benefit plans.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Group has defined contribution plans pursuant to Section 14 to the Severance Pay Law under which the Group pays fixed contributions and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient amounts to pay all employee benefits relating to employee service in the current and prior periods. Contributions to the defined contribution plan in respect of severance or retirement pay are recognized as an expense when contributed simultaneously with receiving the employee's services and no additional provision is required in the financial statements.

The Group also operates a defined benefit plan in respect of severance pay pursuant to the Severance Pay Law. According to the Law, employees are entitled to severance pay upon dismissal or retirement. The liability for termination of employee-employer relation is measured using the projected unit credit method. The actuarial assumptions include rates of employee turnover and future salary increases based on the estimated timing of payment. The amounts are presented based on discounted expected future cash flows using a discount rate determined by reference to yields on Government bonds with a term that matches the estimated term of the benefit obligation.

In respect of its severance pay obligation to certain of its employees, the Company makes current deposits in pension funds and insurance companies ("the plan assets"). Plan assets comprise assets held by a long-term employee benefit fund or qualifying insurance policies. Plan assets are not available to the Group's own creditors and cannot be returned directly to the Group.

The liability for employee benefits presented in the statement of financial position presents the present value of the defined benefit obligation less the fair value of the plan assets, less past service costs and any unrecognized actuarial gains and losses.

Actuarial gains and losses are recognized in statement of income in the period in which they occur.

q. Revenue recognition:

Revenues are recognized in the statement of income when the revenues can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Revenues are measured at the fair value of the consideration received less any trade discounts, volume rebates and returns.

Revenues from credit sales transactions that include a financing element are recorded at present value such that the difference between the fair value of the consideration had credit not been provided and the nominal amount of the consideration is recognized in the statement of income as Finance income using the effective interest method.

The specific criteria for revenue recognition for the following types of revenues are:

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from the sale of goods:

Revenues from the sale of goods are recognized when all the significant risks and rewards of ownership of the goods have passed to the buyer and the seller no longer retains continuing managerial involvement. The delivery date is usually the date on which ownership passes.

Customer discounts:

Current customer discounts are recognized in the financial statements when granted and are deducted from sales.

Customer discounts given at the end of the year and in respect of which the customer is not obligated to comply with certain targets, are recognized in the financial statements proportionately as the sales entitling the customer to said discounts are made.

Customer discounts for which the customer is required to meet certain targets, such as a minimum amount of annual purchases (either quantitative or monetary), an increase in purchases compared to previous periods, etc. are recognized in the financial statements in proportion to the purchases made by the customer during the year that qualify for the target, provided that it is expected that the targets will be achieved and the amount of the discount can be reasonably estimated. The estimate as to meeting the targets is based, among others, on past experience, on the Company's relationship with the customers and on the expected amount of purchases by the customers in the remaining period.

r. Cost of sales and supplier discounts:

Cost of sales includes expenses for loss, storage and conveyance of inventories to the end point of sale. Cost of sales also includes provisions for write-downs of inventories, inventory write offs and provisions for slow-moving inventories.

s. Finance income and expenses:

Finance income comprise interest income on amounts invested, changes in fair value of financial assets at fair value through profit or loss, exchange gains and gains on hedges recognized in the statement of income. Interest income is recognized as it accrues using the effective interest method.

Finance costs comprise interest expenses on borrowings, changes in the time value of provisions, reductions in the fair value of financial assets at fair value through profit or loss, impairment losses of financial assets and losses on hedges recognized in profit or loss. Borrowing costs that are not capitalized to qualifying assets are recognized in the statement of income using the effective interest method.

Gains and losses on exchange differences are reported on a net basis.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

t. Earnings (loss) per share:

Earnings (loss) per share are calculated by dividing the net income attributable to equity holders of the Company by the weighted number of Ordinary shares outstanding during the period. Basic earnings per share only include shares that were actually outstanding during the period. Potential Ordinary shares (employee options) are only included in the computation of diluted earnings per share when their conversion decreases earnings per share or increases loss per share from continuing operations. Further, potential Ordinary shares that are converted during the period are included in diluted earnings per share only until the conversion date and from that date in basic earnings per share. The Company's share of earnings of investees is included based on the earnings per share of the investees multiplied by the number of shares held by the Company.

u. Provisions:

A provision in accordance with IAS 37 is recognized when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect is material, provisions are measured according to the estimated future cash flows discounted using a pre-tax interest rate that reflects the market assessments of the time value of money and, where appropriate, those risks specific to the liability.

Following are the types of provisions included in the financial statements:

Legal claims:

A provision for claims is recognized when the Group has a present legal or constructive obligation as a result of a past event, it is more likely than not that an outflow of resources embodying economic benefits will be required by the Group to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the effect of the time value of money is material, a provision is measured at its present value.

Onerous contract:

A provision for onerous contracts is recognized when the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received by the Group under it. The provision is measured at the lower of the present value of the anticipated cost of exiting from the contract and the present value of the net anticipated cost of fulfilling it.

The Company recognized a provision for payment of net future lease fees for assets in respect of which it has future lease payments in amounts that exceed the future economic benefit expected from the assets (the expected rental income on sub-lease of the asset) since they are no longer in use as the property was abandoned and the activity relocated.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

v. Advertising expenses:

Expenditures incurred on advertising, marketing or promotional activities, such as production of catalogues and promotional pamphlets, are recognized as an expense when the Group has the right of access to the advertising goods or when the Group receives those services.

w. Presentation of statement of comprehensive income:

The Company has elected to present comprehensive income using two statements: a statement of income and a statement of comprehensive income in which all the items recognized in other comprehensive income are presented, excluding net income which is brought forward from the statement of income.

x. Disclosure of new IFRSs in the period prior to their adoption:

IAS 1 - Presentation of Financial Statements:

In June 2011, the IASB issued an amendment to IAS 1 ("the Amendment") which provides guidance for the presentation of other comprehensive income. According to the Amendment, items which may be carried to profit or loss at a later stage (such as upon derecognition or recovery) should be presented separately from items that can never be carried to profit or loss.

The Amendment is to be applied retrospectively commencing from the financial statements for annual periods beginning on January 1, 2013, or thereafter. Earlier application is permitted.

The Company believes that the Amendment is not expected to have a material effect on the financial statements.

IAS 19 (Revised) - Employee Benefits:

In June 2011, the IASB issued IAS 19 (Revised) ("the Standard"). The principal amendments included in the Standard are:

- Actuarial gains and losses will only be recognized in other comprehensive income and not recorded in profit or loss.

- The return on the plan assets is recognized in profit or loss based on the discount rate used to measure the employee benefit liabilities, regardless of the actual composition of the investment portfolio.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- The distinction between short-term employee benefits and long-term employee benefits will be based on the expected settlement date and not on the date on which the employee first becomes entitled to the benefits.

- Past service cost arising from changes in the plan will be recognized immediately.

The Standard is to be applied retrospectively in financial statements for annual periods commencing on January 1, 2013, or thereafter. Earlier application is permitted.

The Company is evaluating the possible impact of the adoption of the Standard but is presently unable to assess the effects, if any, on its financial statements.

IFRS 7 - Financial Instruments: Disclosure:

The amendment to IFRS 7 ("the Amendment") provides new and expansive disclosure requirements regarding the derecognition of financial assets and regarding unusual transfer activity close to the end of a reporting period. The objective of the Amendment is to assist users of financial statements to assess the risks to which the Company may remain exposed from transfers of financial assets and the effect of these risks on the Company's financial position. The Amendment is designed to enhance the reporting transparency of transactions involving asset transfers, specifically securitization of financial assets. The Amendment is to be applied prospectively commencing from the financial statements for periods beginning on January 1, 2012. Earlier application is permitted.

The appropriate disclosures will be included in the Company's financial statements.

IAS 32 - Financial Instruments: Presentation and IFRS 7 - Financial Instruments: Disclosure:

In December 2011, the IASB issued amendments to IAS 32 ("the amendments to IAS 32") regarding the offsetting of financial assets and liabilities. The amendments to IAS 32 clarify, among others, the meaning of "currently has a legally enforceable right of set-off" ("the right of set-off"). Among others, the amendments to IAS 32 prescribe that the right of set-off must be legally enforceable not only during the ordinary course of business of the parties to the contract but also in the event of bankruptcy or insolvency of one of the parties. The amendments to IAS 32 also state that in order for the right of set-off to be currently available, it must not be contingent on a future event, there may not be periods during which the right is not available, or there may not be any events that will cause the right to expire.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Simultaneously in December 2011, the IASB issued amendments to IFRS 7 ("the amendments to IFRS 7") regarding the offsetting of financial assets and liabilities. According to the amendments to IFRS 7, the Company is required, among others, to provide disclosure of rights of set-off and related arrangements (such as collateral agreements), the composition of amounts that are set off, and amounts subject to enforceable master netting arrangements that do not meet the offsetting criteria of IAS 32.
The amendments to IAS 32 are to be applied retrospectively commencing from the financial statements for periods beginning on January 1, 2014, or thereafter. Earlier application is permitted, but disclosure of early adoption is required as well as the disclosures required by the amendments to IFRS 7 as described above. The amendments to IFRS 7 are to be applied retrospectively commencing from the financial statements for periods beginning on January 1, 2013, or thereafter.

The Company estimates that the amendments to IAS 32 are not expected to have a material impact on its financial statements. The required disclosures pursuant to the amendments to IFRS 7 will be included in the Company's financial statements.

IFRS 9 - Financial Instruments:

1. In November 2009, the IASB issued IFRS 9, "Financial Instruments", the first part of Phase 1 of a project to replace IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 ("the Standard") focuses mainly on the classification and measurement of financial assets and it applies to all financial assets within the scope of IAS 39.

   According to the Standard, all financial assets (including hybrid contracts with financial asset hosts) should be measured at fair value upon initial recognition. In subsequent periods, debt instruments should be measured at amortized cost only if both of the following conditions are met:

   - the asset is held within a business model whose objective is to hold assets in order to collect the contractual cash flows.

   - the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

     Notwithstanding the aforesaid, upon initial recognition, the Company may designate a debt instrument that meets both of the abovementioned conditions as measured at fair value through profit or loss if this designation eliminates or significantly reduces a measurement or recognition inconsistency ("accounting mismatch") that would have otherwise arisen.

   Subsequent measurement of all other debt instruments and financial assets should be at fair value.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Financial assets that are equity instruments should be measured in subsequent periods at fair value and the changes recognized in profit or loss or in other comprehensive income, in accordance with the election by the Company on an instrument-by-instrument basis (amounts recognized in other comprehensive income cannot be subsequently transferred to profit or loss). Nevertheless, if equity instruments are held for trading, they should be measured at fair value through profit or loss. This election is final and irrevocable. When an entity changes its business model for managing financial assets it shall reclassify all affected financial assets. In all other circumstances, reclassification of financial instruments is not permitted.

The Standard is effective commencing from January 1, 2015. Earlier application is permitted. Upon initial application, the Standard should be applied retrospectively by providing the required disclosure or restating comparative figures, except as specified in the Standard.

2. In October 2010, the IASB issued certain amendments to the Standard regarding derecognition and financial liabilities. According to those amendments, the provisions of IAS 39 will continue to apply to derecognition and to financial liabilities for which the fair value option has not been elected (designated as measured at fair value through profit or loss); that is, the classification and measurement provisions of IAS 39 will continue to apply to financial liabilities held for trading and financial liabilities measured at amortized cost.

The changes arising from these amendments affect the measurement of a liability for which the fair value option has been chosen. Pursuant to the amendments, the amount of the adjustment to the liability's fair value that is attributable to changes in credit risk should be presented in other comprehensive income. All other fair value adjustments should be presented in profit or loss. If presenting the fair value adjustment of the liability arising from changes in credit risk in other comprehensive income creates an accounting mismatch in profit or loss, then that adjustment should also be presented in profit or loss rather than in other comprehensive income.

Furthermore, according to the amendments, derivative liabilities in respect of certain unquoted equity instruments can no longer be measured at cost but rather only at fair value.

The amendments are effective commencing from January 1, 2015. Earlier application is permitted provided that the Company also adopts the provisions of the Standard regarding the classification and measurement of financial assets (the first part of Phase 1). Upon initial application, the amendments are to be applied retrospectively by providing the required disclosure or restating comparative figures, except as specified in the amendments.

The Company believes that the Standard is not expected to have a material effect on the financial statements.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

IFRS 13 - Fair Value Measurement:

IFRS 13 establishes guidance for the measurement of fair value, to the extent that such measurement is required according to IFRS. IFRS 13 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. IFRS 13 also specifies the characteristics of market participants and determines that fair value is based on the assumptions that would have been used by market participants. According to IFRS 13, fair value measurement is based on the assumption that the transaction will take place in the asset's or the liability's principal market, or in the absence of a principal market, in the most advantageous market.

IFRS 13 requires an entity to maximize the use of relevant observable inputs and minimize the use of unobservable inputs. IFRS 13 also includes a fair value hierarchy based on the inputs used to determine fair value as follows:

Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - unobservable inputs (valuation techniques that do not make use of observable inputs).

IFRS 13 also prescribes certain specific disclosure requirements.

The new disclosures, and the measurement of assets and liabilities pursuant to IFRS 13, are to be applied prospectively for periods commencing after the Standard's effective date, in financial statements for annual periods commencing on January 1, 2013 or thereafter. Earlier application is permitted. The new disclosures will not be required for comparative data.

The appropriate disclosures will be included in the Company's financial statements upon initial adoption of IFRS 13.

As for the effect on the financial statements, the Company believes that IFRS 13 is not expected to have a material impact on its financial statements.

y. Reclassification:

The Company reclassified amount previously presented in other accounts receivable, into deferred taxes.

Comparative data were reclassified, and accordingly, $ 276 thousand were reclassified from other accounts receivable to deferred taxes in 2010.

NOTE 3:- CASH AND CASH EQUIVALENTS

Composition by currency:

	December 31, 2011	December 31, 2010
U.S. dollars	1,119	96
Euros	91	15
GBP	144	821
NIS	333	51
	1,687	983

NOTE 4:- TRADE RECEIVABLES

a. Composition:

	December 31, 2011	December 31, 2010
Open accounts	2,098	3,328
Checks receivable	3	36
	2,101	3,364
Less - allowance for doubtful accounts	84	394
	2,017	2,970

Trade receivables are non-interest bearing and are generally for 60-90 day terms.

b. The movements in the allowance for doubtful accounts were as follows:

	Individually impaired
At January 1, 2010	1,368
Charge for the year	54
Derecognition of bad debts	(1,028)
At December 31, 2010	394
Charge for the year	8
Reversal of collected doubtful accounts	(33)
Derecognition of bad debts	(273)
Deconsolidated Company	(12)
At December 31, 2011	84

NOTE 4:- TRADE RECEIVABLES (Cont).

c. An analysis of past due but not impaired trade receivables (allowance for doubtful accounts), trade receivables, net, with reference to reporting date:

	Neither past due nor impaired	Past due but not impaired				Total
		< 30 days	30 - 60 days	60 -90 days	> 90 day	
December 31, 2011	1,337	615	32	26	7	2,017
December 31, 2010	1,669	43	795	369	94	2,970

NOTE 5:- OTHER ACCOUNTS RECEIVABLE

	December 31,	
	2011	2010
Prepaid expenses	110	76
Advances to suppliers	1,412	964
Government authorities	390	394
Other receivables	-	50
	1,912	1,484

NOTE 6:- INVENTORIES

	December 31,	
	2011	2010
Finished products	1,270	1,908
Work in progress	-	596
Raw and auxiliary materials	-	1,953
	1,270	4,457
Inventory in transit	153	1,037
	1,423	5,494

The provisions for slow-moving inventories as of December 31, 2011 and 2010 are $ 1,579 and $ 1,339, respectively.

NOTE 7:- PROPERTY, PLANT AND EQUIPMENT

a. Composition and movement:

	Building	Installations and leasehold improvements	Machinery and equipment	Motor vehicles	Office furniture and equipment	Total
Cost:						
Balance as of January 1, 2010	1,456	5,915	4,946	177	3,512	16,006
Acquisitions during the year	-	-	67	-	53	120
Disposals during the year	-	-	-	(104)	(45)	(149)
Currency translation differences	(64)	-	-	(1)	(5)	(70)
Balance as of December 31, 2010	1,392	5,915	5,013	72	3,515	15,907
Acquisitions during the year	-	-	201	12	102	315
Disposals during the year	-	-	(787)	(44)	-	(831)
Currency translation differences	10	-	-	-	-	10
Deconsolidated company	(1,402)	-	-	-	(141)	(1,543)
Balance as of December 31, 2011	-	5,915	4,427	40	3,476	13,858
Accumulated depreciation:						
Balance as of January 1, 2010	8	3,590	4,035	89	3,116	10,838
Provision during the year	28	2,146	871	10	98	3,153
Disposals during the year	-	-	-	(42)	(27)	(69)
Currency translation differences	-	-	-	(1)	(1)	(2)
Balance as of December 31, 2010	36	5,736	4,906	56	3,186	13,920
Provision during the year	27	170	42	11	129	379
Disposals during the year	-	-	(771)	(26)	-	(797)
Currency translation differences	(1)	-	-	(1)	(1)	(3)
Deconsolidated company	(62)	-	-	-	(103)	(165)
Balance as of December 31, 2011	-	5,906	4,177	40	3,211	13,334
Depreciated cost as of December 31, 2011	-	9	250	-	265	524
Depreciated cost as of December 31, 2010	1,356	179	107	16	329	1,987

b. The Company accelerated the depreciation expenses in respect to leasehold improvements and machinery and equipment over the expected useful period, which is due to the Company's decision to vacate the buildings of the Company's plant and administration and the decision to cease self manufacturing.

As a result of the depreciation acceleration, the Company recorded in 2010 an expense in the approximate amount of $ 2,502 and for the period ended December 31, 2011 an additional approximate amount of $ 131.

NOTE 8:- INTANGIBLE ASSETS

Internal development costs of production files that have been capitalized are composed as follows:

	December 31, 2011	December 31, 2010
Cost:		
As of January 1	504	392
Additions	-	112
Amortizations	(101)	-
As of December 31	403	504

The intangible assets became available for use in 2011 and are being depreciated over a period of 5 years.

NOTE 9:- SHORT-TERM CREDIT FROM BANKS

a. Composition:

	Annual interest rate % *)	December 31, 2011	December 31, 2010
Short-term loans:			
NIS	7.1	-	338
U.S. dollars	2.2	-	900
		-	1,238
Long-term loans from banks		-	**) 887
Current maturities of long-term loans (see Note 12)		1,244	1,392
		1,244	3,517

*) Weighted average annual interest rate. The effective interest rate is equal to the average interest rate.

**) Classified from long-term loans due to violation of financial covenants - see Note 12b.

b. Liens:

The Company recorded a floating charge (a non-specific lien on all assets of the Company on which there is no previous specific lien) on the Company's assets in favor of one of the Company's banks.

NOTE 10:- TRADE PAYABLES

	December 31,	
	2011	2010
Open accounts	2,794	4,926
Checks payable	2	98
	2,796	5,024

Trade payables are non-interest bearing and generally have terms of 60-90 days.

NOTE 11:- OTHER CURRENT LIABILITIES

	December 31,	
	2011	2010
Accrued expenses	193	426
Accrued salaries and related expenses	249	819
Government authorities	-	17
Onerous contract	405	511
Others	78	389
	925	2,162

NOTE 12:- LOANS FROM BANKS

a. Composition:

	Average interest rate (1)	December 31,	
		2011	2010
	%		
U.S. dollars	LIBOR + 1.6 (2)	-	201
U.S. dollars	LIBOR + 1.9 (2)	-	100
U.S. dollars	LIBOR + 1.7 (3)	884	1,870
U.S. dollars	LIBOR + 5.1 (3)	887	-
GBP		-	1,173
		1,771	3,344
Less - current maturities		1,244	1,392
		527	1,952
Classified to current liabilities (b)		-	(887)
		527	1,065

(1) As of December 31, 2011, the effective interest rate is equal to the average interest rate.

(2) As of December 31, 2011, six-months LIBOR is 0.8% (2010 - 0.46%).

(3) As of December 31, 2011, three-months LIBOR is 0.58% (2010 - 0.3%).

NOTE 12:- LOANS FROM BANKS (Cont.)

b. In May 2011 the Company entered into agreement with its main bank regarding new covenant as follows:

- Tangible equity to balance sheet ratio – at least 15% as of December 31, 2011, at least 20% as of December 31, 2012 and onwards.

- Debt to EBITDA ratio - will not be more than 5 as of December 31, 2011, will not be more than 4 as of December 31, 2012 and December 31, 2013 and will not be more than 3 as of December 31, 2014 and onwards.

- Operating profit - a positive operating profit in each four consecutive quarters starting from January 1, 2011.

As of December 31, 2011 The Company is meeting its bank covenants.

Moreover the Company has fully repaid loans from two of its major banks, which removes the floating charge of the Company's assets.

As of December 31, 2010, the Company did not meet a specific ratio and, accordingly, long-term loans in an amount of $ 887 were reclassified to current liabilities (see Note 9).

c. According to their original contractual terms, the long-term loans are repayable in future years, as follows:

	December 31,	
	2011	2010
First year	1,244	1,392
Second year	351	996
Third year	176	108
Fourth year	-	108
Fifth year	-	740
	1,771	3,344

NOTE 13:- EMPLOYEE BENEFIT LIABILITIES, NET

Employee benefits consist of short-term benefits, post-employment benefits.

Post-employment benefits:

According to the labor laws and Severance Pay Law in Israel, the Company is required to pay compensation to an employee upon dismissal or retirement or to make current contributions in defined contribution plans pursuant to Section 14 to the Severance Pay Law, as specified below. The Company's liability is accounted for as a post-employment benefit. The computation of the Company's employee benefit liability is made in accordance with a valid employment contract based on the employee's salary and employment term which establish the entitlement to receive the compensation.

The post-employment employee benefits are normally financed by contributions classified as defined benefit plans or as defined contribution plans, as detailed below.

a. Defined contribution plans:

Section 14 to the Severance Pay Law, 1963 applies to part of the compensation payments, pursuant to which the fixed contributions paid by the Group into pension funds and/or policies of insurance companies release the Group from any additional liability to employees for whom said contributions were made. These contributions and contributions for compensation represent defined contribution plans.

	Year ended December 31,	
	2011	2010
Expense in respect of defined contribution plans	97	247

b. Defined benefit plans:

The Company accounts for that part of the payment of compensation that is not covered by contributions in defined contribution plans, as above, as a defined benefit plan for which an employee benefit liability is recognized and for which the Company deposits amounts in central severance pay funds and in qualifying insurance policies.

1. Expenses recognized in the statement of income:

	Year ended December 31,	
	2011	2010
Current service cost	17	50
Interest cost on benefit obligation	57	89
Expected return on plan assets	(48)	(70)
Net actuarial gain (loss) recognized in the year	(180)	137
Total employee benefit expenses	(154)	206
Actual return on plan assets	(2)	212

NOTE 13:- EMPLOYEE BENEFIT LIABILITIES, NET (Cont.)

2. The plan assets, net:

	December 31,	
	2011	**2010**
Defined benefit obligation	565	2,015
Fair value of plan assets	(425)	(1,776)
	140	239
Reclassified to current liabilities	-	74
Total liabilities, net	140	165

3. Changes in the present value of defined benefit obligation:

	December 31,	
	2011	**2010**
Balance at January 1,	2,015	2,070
Interest cost	57	89
Current service cost	17	50
Benefits paid	(1,557)	(306)
Net actuarial loss (gain)	86	(9)
Exchange differences	(53)	121
Balance at December 31,	565	2,015

4. Plan assets:

a) Plan assets comprise assets held by a long-term employee benefit fund and qualifying insurance policies.

b) The movement in the fair value of the plan assets:

	December 31,	
	2011	**2010**
Balance at January 1,	1,776	1,675
Expected return	48	70
Benefits paid	(1,261)	(203)
Net actuarial gain (loss)	(94)	128
Exchange differences	(44)	106
Balance at December 31,	425	1,776

5. The principal actuarial assumptions used are as follows:

NOTE 13:- EMPLOYEE BENEFIT LIABILITIES, NET (Cont.)

	December 31,	
	2011	2010
Discount rate	4.4%	4.65%
Future salary increase	5%	5%

NOTE 14:- TAXES ON INCOME

a. Tax laws applicable to the Company:

1. Income Tax (Inflationary Adjustments) Law, 1985:

According to the law, until 2007, the results for tax purposes were adjusted for the changes in the Israeli CPI.

In February 2008, the "Knesset" (Israeli parliament) passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law starting 2008 and thereafter. Since 2008, the results for tax purposes are measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. Adjustments relating to capital gains such as for sale of property (betterment) and securities continue to apply until disposal. Since 2008, the amendment to the law includes, among others, the cancellation of the inflationary additions and deductions and the additional deduction for depreciation.

2. The Law for the Encouragement of Industry (Taxation), 1969:

The Company has the status of an "industrial company", as implied by this law. According to this status and by virtue of regulations published thereunder, the Company is entitled to claim a deduction of accelerated depreciation on equipment used in industrial activities, as determined in the regulations issued under the Inflationary Law.

b. Tax rates applicable to the Group:

1. The Israeli corporate tax rate was 26% in 2009, 25% in 2010 and 24% in 2011.

A Company is taxable on its real (non-inflationary) capital gains at the corporate tax rate in the year of sale. A temporary provision for 2006-2009 stipulates that the sale of an asset other than a quoted security (excluding goodwill that was not acquired) that had been purchased prior to January 1, 2003, and sold by December 31, 2009, is subject to corporate tax as follows: the part of the real capital gain that is linearly attributed to the period prior to December 31, 2002 is subject to the corporate tax rate in the year of sale as set forth in the Israeli Income Tax Ordinance, and the part of the real capital gain that is linearly attributed to the period from January 1, 2003, through December 31, 2009, is subject to tax at a rate of 25%.

NOTE 14:- TAXES ON INCOME (Cont).

On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among others, cancels effective from 2012, the scheduled progressive reduction in the corporate tax rate. The Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly.

The effect of the abovementioned change on the financial statements is immaterial.

2. The principal tax rates applicable to the subsidiaries whose place of incorporation is outside Israel are:

A Company incorporated in the U.S. - weighted tax at the rate of 38.63% (Federal tax, State tax and City tax of the city where the Company operates).

Company incorporated in England - tax at the rate of 26%.

c. Tax assessments:

The Company has not received final tax assessments since its incorporation, however, the assessments of the Company are deemed final through 2007.

d. Deferred taxes:

The deferred taxes are reflected in the statement of financial position as follows:

	December 31,	
	2011	**2010**
Non-current assets	483	*) 491
Non-current liabilities	-	(379)
	483	*) 112

*) Reclassified, see note 2y.

Deferred tax assets are computed at an average tax rate of approximately 25% and 24% for 2011 and 2010, respectively.

The Group recorded deferred tax assets, principally for tax loss carryforwards and also for other temporary differences, as of December 31, 2011 and 2010 in the amount of $ 483 and 491, respectively (see e below). The deferred tax assets were recorded based on the Group's management best estimation of realization of these losses and temporary differences in the foreseeable future.

NOTE 14:- TAXES ON INCOME (Cont).

e. Changes in deferred taxes:

	Year ended December 31, 2011	Year ended December 31, 2010
Balance at the beginning of the year	112	*) 491
Change during the year	34	(379)
Adjustment of deferred tax balances following change in exchange rate	(12)	-
Deconsolidation Company	349	-
Balance at the end of the year	483	*) 112

*) Reclassified.

f. Taxes on income included in statements of income:

	Year ended December 31, 2011	Year ended December 31, 2010
Current taxes	88	144
Deferred taxed	(34)	379
	54	523

NOTE 14:- TAXES ON INCOME (Cont).

g. Theoretical tax:

The reconciliation between the tax expense, assuming that all the income and expenses, gains and losses in the statement of income were taxed at the statutory tax rate and the taxes on income recorded in profit or loss is as follows:

	Year ended December 31,	
	2011	**2010**
Income (Loss) before taxes on income	2,386	(5,328)
Taxes computed at statutory tax rate of 24% (2010- 25%)	573	(1,332)
Increase (decrease) in tax due to:		
Non-deductible expenses	12	38
Exempt income	(338)	-
Cost of share-based payments	5	(42)
Change in tax laws in a subsidiary	-	379
Losses and other items for which deferred taxes were not provided	-	1,460
Utilization of previously unrecognized tax losses and other items	(184)	-
Differences in the basis of measurement (U.S.$ - NIS) *) and others	(14)	20
	54	523

*) The amount represents the difference resulting from the basis of measurement for income tax purposes in Israel (calculated based on the New Israeli Shekel) and the measurement currency of the Company (the U.S. dollars).

h. Carryforward losses for tax purposes:

The Group's carryforward losses for tax purposes as of December 31, 2011 and 2010 amount to approximately $ 18,171 and $ 21,099, respectively. With respect to tax losses carryforward of approximately $ 16,239 and $ 19,135, no deferred tax asset was recognized as of December 31, 2011 and 2010, respectively.

NOTE 15:- COMMITMENTS AND CONTINGENT LIABILITIES

a. Legal claims:

The Company was sued by a landlord in the approximate amount of $ 770, as a consequence of controversy regarding the rental payments.

During the reporting period, the Company and the landlord signed a settlement agreement; according to the settlement agreement the Company paid the landlord an amount of $ 726 to remove its legal claim and any future claims regarding the rental payments.

b. Royalties:

1. The Company is obligated to pay royalties of 2%-3.5% of the revenues from products in the development of which the Chief Scientist participated. The royalties are limited to the amount of the grant received, linked to the U.S dollar. Total grants received as of December 31, 2011 and 2010 amounted to approximately $ 1,670. The balance of contingent royalties is approximately $ 1,238. Since the Company does not manufacture and sell the products for which it had received the grants, it does not expect to pay additional royalties in the future, therefore no liability was included in the financial statements.

   Under the conditions of an agreement for participation by the Bi-National Fund for Research and Development ("BIRD") in joint R&D programs between the Group and a U.S. company, BIRD granted grants to the Group. In consideration for this grant, BIRD is entitled to royalties of between 2.5% and 5% of the gross sales of products resulting from this research, up to the amount of the grant, linked to the U.S dollar. Thereafter, BIRD will be entitled to royalties of 2.5% of sales up to an additional amount equaling half of the grant received. On January 1, 2003, the benefits and the obligations deriving from this agreement were transferred to the Company from Metis. The grants received by the Company and the balance of contingent royalties as of December 31, 2011 and 2010 amounted to approximately $ 340. It was also agreed with BIRD that should one of the companies register a patent on a product developed, the Group will also pay royalties to BIRD at the rate of 1.5% of the gross sales of the product resulting from the research, for the duration of the patent.

   Since the Company does not manufacture and sell the products for which it had received the grants, it does not expect to pay additional royalties in the future, therefore no liability was included in the financial statements.

NOTE 15:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

c. Operating leases:

The Company entered into agreements with Metis to lease the plant and administration building until 2021 and 2024, respectively. The Company has an option to cancel the part of the leases in 2011 and 2014, respectively. The rent is linked to the higher of the change in Israel's CPI or the exchange rate of the NIS in relation to the U.S. dollar. Certain of the leases have escalation clauses.

During 2010 Following the Company's decision to vacate its plant and administration buildings, the Company recognized the remaining obligation of lease expenses.

In February 2011, the Company utilized its option and canceled the lease agreement for 2 out of 4 floors in the plant building, as agreed.

In December 2011, the Company and the administration building landlord signed settlement agreement terminating the lease agreement immediately. (See note 15a)

As of the balance sheet date, the Company has no obligation regarding any future lease payments related to the administration buildings.

The foreign subsidiaries rent their facilities under various operating lease agreements, which expire on various dates, the latest of which is in 2010.

d. After the balance sheet date the Company opened a stand-by letter of credit. In order to ensure the Company's obligation towards the bank, the Company was required to deposit an amount of $ 200 and to create a first degree charge and lien over the deposit in favor of the bank.

NOTE 16:- EQUITY

a. The share capital is composed as follows:

	December 31, 2011		December 31, 2010	
	Authorized	Issued and outstanding	Authorized	Issued and outstanding
	Number of shares			
Ordinary shares of NIS 5 par value each	50,000,000	13,712,848	50,000,000	10,162,848

The authorized share capital of the Company is NIS 250,000,000 comprised of 50,000,000 authorized Ordinary shares, par value NIS 5 each.

NOTE 16:- EQUITY (Cont.)

b. Stock Option Plan:

1. In June 8, 2005, the Company's Board of Directors adopted a share option plan according to which up to 290,735 options exercisable into Ordinary shares of the Company may be granted to officers, directors, employees and consultants of the Group.

2. In May 9, 2006, the BOD resolved to increase the number of shares available for option grants under the June 2005 share option plan up to 500,000 options.

3. In June 14, 2011 additional allocation of 330,000 options to the Company's CEO, directors and top management of Risco Ltd., the controlling shareholders, was approved by the audit committee and the board of directors. The final approval by the Company's share holders was received on October 10, 2011.

Measurement of the fair value of equity-settled share options:

The Company uses the binomial model when estimating the grant date fair value of equity-settled share options. The measurement was made at the grant date of equity-settled share options since the options were granted to employees.

The following table lists the inputs to the binomial model used for the fair value measurement of equity-settled share options for the above plan:

Dividend yield – 0%
Expected volatility of the share prices – 77.3%
Risk-free interest rate – 1.89%
Expected life of share options – 10 years
Share price – € 1.010

Based on the above inputs, the fair value of the options was determined at $ 212 (€ 164) at the grant date.

The options granted will expire 10 years after the date of grant and vest over a period of 3 years. The exercise price of the options granted is € 1.5.

The expected life of the share options is based on historical data and is not necessarily indicative of the exercise patterns of share options that may occur in the future.

The expected volatility of the share prices reflects the assumption that the historical volatility of the share prices is reasonably indicative of expected future trends.

NOTE 16:- EQUITY (Cont.)

4. Movement during the year:

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, share options during the years:

	Year ended December 31,			
	2011		2010	
	Number of options	WAEP (U.S.$)	Number of options	WAEP (U.S.$)
Share options outstanding at beginning of year	216,059	5.32	320,375	5.51
Share options granted during the year	330,000	1.94	-	-
Share options forfeited during the year	(4,878)	6.59	(104,316)	5.90
Share options outstanding at end of year	541,181	3.25	216,059	5.32
Share options exercisable at end of year	201,435	5.22	201,435	5.22

5. During 2010 and 2011, the employment of certain officers and employees of the Company, who were previously granted options, was terminated. Consequently, 4,878 and 104,316 of the options were forfeited, respectively.

Total expenses (income) of share-based payments amounted to $ 21 and $ (168) for 2011 and 2010, respectively.

NOTE 17:- FINANCIAL INSTRUMENTS

a. The financial assets and financial liabilities in the statement of financial position are classified by groups of financial instruments pursuant to IAS 39:

	December 31,	
	2011	**2010**
Financial assets:		
Financial assets at fair value through profit or loss:		
Designated as such upon initial recognition	-	46
Loans and receivables	2,017	3,842
Financial liabilities:		
Financial liabilities measured at amortized cost	5,573	15,561
Financial liabilities at fair value through profit or loss:		
Designated as such upon initial recognition	18	-

b. Financial risks factors:

The Group's activities expose it to various financial risks such as market risk (foreign exchange risk and interest rate risk), credit risk and liquidity risk. The Group's comprehensive risk management plan focuses on activities that reduce to a minimum any possible adverse effects on the Group's financial performance.

The Company's management oversees the risks in accordance with the policies approved by the Board.

1. Market risks:

a) Foreign exchange risk:

The Group operates in a large number of countries and is exposed to foreign exchange risk resulting from the exposure to different currencies. Foreign exchange risk arises on forward commercial transactions, recognized assets and liabilities that are denominated in a foreign currency other than the functional currency. Accounting department is responsible for managing the net position of each foreign currency by the use of forward exchange contracts and other hedging tools.
Management's policy is to hedge between 40% and 70% of forecasted transactions in every principal currency over the next 12 months.

NOTE 17:- FINANCIAL INSTRUMENTS (Cont.)

The Group has forward foreign currency contracts and cylinder transactions to manage some of its transactions exposure to fluctuations in exchange rates. These forward foreign currency contracts and cylinder transactions are not designated as cash flow, fair value or net investment hedges and are entered into for periods consistent with the periods of currency transaction exposure. Such derivatives do not qualify for hedge accounting.

As of December 31, 2011 and 2010, the Company's monetary liabilities in NIS exceeded monetary assets by $ 2,149 and $ 2,207, respectively.

As of December 31, 2011 and 2010, the Company's monetary assets in Euro exceeded monetary assets by $ 291 and $ 373, respectively.

As of December 31, 2011 and 2010, the Company's monetary assets in GBP exceeded monetary assets by $ 917 and $ 3,212, respectively.

b) Interest rate risk:

The Group is exposed to the risk of changes in the market interest rates on long-term loans with floating interest rates.

2. Credit risk:

The Group monitors and reduces its credit risk by using a policy to ensure collection through sales of its products to wholesalers with an appropriate credit history and by insuring the customers who received a credit line.

Credit risk may arise from the exposure of holding several financial instruments with a single entity or from entering into transactions with several groups of debtors with similar economic characteristics whose ability to discharge their obligations will be similarly affected by changes in economic or other conditions. Factors that have the potential of creating concentrations of risks consist of the nature of the debtors' activities, such as their business sector, the geographical area of their operations and the financial strength of groups of borrowers.

The Company regularly monitors the credit extended to its customers. The Company provides an allowance for doubtful accounts based on the factors that affect the credit risk of certain customers, past experience and other information.

3. Liquidity risk:

The Group monitors its risk to a shortage of funds using a monthly and daily budget tool.
The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank overdrafts and bank loans.

NOTE 17:- FINANCIAL INSTRUMENTS (Cont.)

The maturities of the financial liabilities of the Group are for one year, except for the bank loans and rent expenses. The long-term loans are repayable in future years based on contractual undiscounted payments, as follows:

	December 31,	
	2011	2010
First year	4,638	12,409
Second year	777	1,594
Third year	176	679
Fourth year	-	55
Fifth year	-	824
	5,591	15,561

c. Fair value:

The carrying amount of cash and cash equivalents, trade receivables, other accounts receivable, credit from banks, trade payables and other accounts payable approximate their fair value.

d. Classification of financial instruments by fair value hierarchy:

The financial instruments presented in the balance sheet at fair value are with similar characteristics using the following fair value hierarchy which is determined based on observable market data (valuation techniques which use inputs that are not based on observable market data).

Financial assets measured at fair value:

	December 31,	
	2011	2010
Financial assets at fair value through profit or loss:		
Non-hedging derivatives	-	46

Financial liabilities measured at fair value:

	December 31,	
	2011	2010
Financial liabilities at fair value through profit or loss:		
Non-hedging derivatives	18	-

NOTE 17:- FINANCIAL INSTRUMENTS (Cont.)

e. Sensitivity tests relating to changes in market factors:

	Year ended December 31, 2011	Year ended December 31, 2010
Sensitivity test to changes in the NIS exchange rate:		
Gain (loss) from the change:		
Increase of 5% in the NIS rate	(204)	(128)
Decrease of 5% in the NIS rate	204	128
Sensitivity test to changes in the Euro exchange rate:		
Gain (loss) from the change:		
Increase of 5% in the Euro rate	15	19
Decrease of 5% in the Euro rate	(15)	(19)
Sensitivity test to changes in the GBP exchange rate:		
Gain (loss) from the change:		
Increase of 5% in the GBP rate	46	91
Decrease of 5% in the GBP rate	(46)	(91)

NOTE 18:- REVENUES

	Year ended December 31, 2011	Year ended December 31, 2010
Foreign:		
Europe	22,363	23,524
Americas	458	1,320
Other countries	1,316	1,392
	24,137	26,236
Domestic - Israel	27	481
	24,164	26,717
Includes sales to one major customer	5,007	5,448

NOTE 19:- COST OF REVENUES

	Year ended December 31, 2011	Year ended December 31, 2010
Purchases and changes in raw and auxiliary materials	11,747	13,961
Labor	1,157	2,850
Manufacturing and other expenses	689	1,724
Depreciation	147	436
	13,740	18,971
Changes in inventories of finished products and work-in-progress	2,005	(633)
	15,745	18,338

NOTE 20:- RESEARCH AND DEVELOPMENT EXPENSES

	Year ended December 31, 2011	Year ended December 31, 2010
Salaries and related expenses	707	939
Other	1,026	945
	1,733	1,884

NOTE 21:- SELLING AND MARKETING EXPENSES

	Year ended December 31, 2011	Year ended December 31, 2010
Salaries and related expenses	1,840	2,094
Commissions	-	238
Advertising	330	113
Foreign travel and transportation	338	756
Rent	-	216
Other	370	423
	2,878	3,840

NOTE 22:- GENERAL AND ADMINISTRATIVE EXPENSES

	Year ended December 31, 2011	2010
Salaries and related expenses	678	804
Management and consulting fees	324	733
Allowance for doubtful accounts and bad debts	25	54
Depreciation	111	203
Other	839	1,373
	1,977	3,167

NOTE 23:- OTHER EXPENSES, NET

	Year ended December 31,	
	2011	2010
	Dollars in thousands	
Capital loss (gain) on sale of fixed assets	(27)	7
Onerous contract (see Note 15)	211	1,712
Accelerated depreciation (see Note 7)	131	2,502
Other	-	229
	315	4,450

NOTE 24:- FINANCIAL INCOME AND EXPENSES

	Year ended December 31, 2011	2010
a. Financial income:		
Foreign exchange differences	40	52
Other	11	10
	51	62
b. Financial expenses:		
Bank borrowings, net	387	382
Foreign exchange differences	-	25
Other	18	21
	405	428

NOTE 25:- NET PROFIT (LOSS) PER SHARE

The following reflects the net loss and share data used in the basic and diluted net loss per share computations:

	Year ended December 31,	
	2011	2010
Profit (loss) attributable to Ordinary shares for computing basic and diluted net loss per share	2,332	(5,851)
Weighted average number of Ordinary shares for computing basic net profit (loss) per share	13,002,848	10,162,848
Adjusted weighted average number of Ordinary shares for computing diluted profit (loss) per share	13,002,848	10,162,848

In the calculation of the diluted net loss per share for the years ended December 31, 2011 and 2010, all share options were not taken into account because of the anti-dilutive effect.

NOTE 26:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES

a. Balances with related parties:

	December 31,	
	2011	2010
Short-term credit	-	3,817
Trade Payables	(2,437)	-

b. Transactions with related parties:

	Year ended December 31,	
	2011	2010
Manufacturing services agreement (see e 2 below):		
Raw material sales *)	(2,306)	(76)
Purchases of finished goods	4,299	-
Management service agreement (see e 1 below)	300	122
Interest due from line of credit (see e 4 below)	25	41
Research and development services (see g below)	747	-

*) Based on Company's cost, used for manufacturing.

NOTE 26:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES (Cont.)

c. During the reported period, the Company's controlling shareholder, Risco Ltd., purchased raw materials in the approximate amount of $ 4,300 to be used by subcontractor from China for the production of finished goods, which were billed back-to-back through the Company.

The transaction was approved by the audit committee and board of directors and on October 10, 2011 was approved by the Company’s shareholders.

d. Previous Management and shareholders

1. Mr. Bob Marbut, was the Chairman of the Board of Directors and an indirect controlling shareholder of the Company and acted as CEO and president of a subsidiary in the United States ("STG"). In consideration for his services, Mr. Marbut was entitled to an annual salary of $ 150.

2. Mr. Ron Chaimovsky, a director of the Company, provided management and consultation services to the Company. In consideration for his services, Mr. Chaimovsky was entitled to an annual salary of $ 150.

On August 12, 2010, the Company decided to terminate Bob Marbut's and Roni Chaimovski's service agreements, effective immediately.

e. After approval by the Company's audit committee, the shareholders, in a special general meeting on August 12, 2010, approved the agreement that the Company had entered into with Risco, which includes the following:

1. Management services agreement - Risco is willing to exert its efforts and utilize its professional connections in order to assist the Company in the following fields: (i) sales administration services; (ii) IT and computerized systems; (iii) finance management and accounting; (iv) human resource; (v) directors and consulting services; (vi) legal and company secretarial services.

   The Company shall pay Risco for all services rendered by it under this agreement, payable not less often than monthly and in accordance with the Company's normal and reasonable payment payroll practices regarding service providers, an annual gross amount of $ 300. The annual amount shall be adjusted on a yearly basis in accordance with the change in the Company's revenues from sales compared to the revenue from sales of the preceding year, but in any event shall not be less than the base amount.

2. Manufacturing services agreement – the Company wishes to retain Risco services for the purpose of manufacturing certain products of the Company, on a non-exclusive basis. Prices shall be provided by the service provider, and agreed on by the parties.

NOTE 26:- BALANCES AND TRANSACTIONS WITH RELATED PARTIES (Cont.)

3. Distribution agreement - Risco has the facilities to import, promote, sell, market and distribute the products in the territory (as defined in the agreement) and is willing to act as the supplier's non-exclusive distributor of the products in the territory. The distributor and supplier intend that the transfer prices for the products, shall be, in the aggregate for all products for each calendar year, at arm’s length prices.

4. The Company received a line of credit, in the amount of up to $ 6,500 from Risco. Any amount taken by the Company from the line of credit shall bear an annual interest of LIBOR+2.5%, charged on a quarterly basis. As of December 31, 2011, the Company converted the credit line to equity as part of Private placement for Risco, see d below.

f. In a private placement effected on March 14, 2011, the Company issued 3,550,000 Ordinary shares of the Company to the controlling shareholder, Risco Ltd., at a price per share of NIS 5.00, for a total consideration of NIS 17,750 thousand (approximately $ 5,000) which was to through conversion of outstanding credit line to equity. The private placement was approved in a special general meeting of the Company's shareholders that took place on February 16, 2011.

g. After approval by the Company's audit committee and the Company's shareholders, on June 16, 2011, the Company had entered into an R&D service agreement with a service provider controlled by the controlling shareholder of the Company's largest and controlling shareholder.

h. During the reported period, the Company’s management had decided to cease the production of certain products. As a result of the management decision and in accordance to the Manufacturing service agreement with the controlling shareholders, the Company recorded an expense in total amount of $228 due to unused raw materials which was returned from the controlling shareholders.

NOTE 27:- GEOGRAPHIC INFORMATION

Revenues reported in the financial statements derive from the Company's country of domicile (Israel) and foreign countries based on the location of the customers, are as follows:

	Year ended December 31,	
	2011	**2010**
Israel	27	481
Europe	22,363	23,524
Other foreign countries	1,774	2,712
	24,164	26,717

The carrying amounts of non-current assets (property, plant and equipment and intangible assets) in the Company's country of domicile (Israel) and in foreign countries based on the location of the assets, are as follows:

	Year ended December 31,	
	2011	**2010**
Israel	927	1,084
Foreign countries	-	1,407
	927	2,491

NOTE 28:- SIGNIFICANT EVENTS DURING THE REPORTED PERIOD

a. In July 31, 2011, EL USA Inc, the Company's subsidiary, has been liquidated. The liquidation was approved by the board of directors on June 14, 2011.

b. Following the Board's resolution, dated July 13, 2011, to up-listing from the General Standard to the Prime Standard, the Deutsche Bourse announced the Company's transfer to trading in the Prime Standard segment on August 15, 2011.

c. In November 28, 2011, the Company sold its UK subsidiary in a Management Buyout transaction.

Under the Management Buyout agreement, the Company receives a consideration of GBP 1.8 million which was paid in cash at the closing date. According to the agreement, inventory valued at GBP 130 thousand was returned to the Company, which had been purchased in the past by the subsidiary from the Company, without any additional consideration. Furthermore, the parties agreed on the termination of the distribution agreement between the Company and its UK subsidiary and a mutual non–competition-clause for a period of three years from closing date.

The Company recorded a gain from sale of subsidiary in the total amount of $ 1,224.

SCHEDULE OF ACTIVE INVESTEES

Entity	Place of incorporation
Sectec Global Inc.	United States

The investee is wholly-owned subsidiary held directly by the Company for all reporting periods.

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