



## **Orad Hi-Tec Systems Ltd ('Orad' or the 'Company')**

### **Record results for the fiscal year 2007 and the quarter ended December 31, 2007**

**Tel Aviv, March 3, 2008** – Orad Hi-Tec Systems Ltd (Frankfurt - Prime Standard; London - AIM. Symbol: OHT), a leading developer, marketer and distributor of state-of-the-art, 3D graphical solutions for the broadcasting, advertising and visual simulation markets, announced today record results for the fiscal year 2007 and the quarter ended December 31, 2007.

#### **Highlights:**

- **Revenues for 2007 increased by 29% to US\$22.9 million compared to US\$17.7 million in 2006**
- **Revenues for Q4/07 increased by 49% to US\$6.9 million compared to US\$4.6 million in Q4/06 and by 12% compared to Q3/07**
- **Gross margin for 2007 improved to 66% from 61% in 2006**
- **Net profit increased by 170% to US\$1.7 million in 2007 compared to net profit of US\$0.6 million in 2006**
- **Cash climbed to US\$14 million with positive cash flow of US\$4 million in 2007 and positive cash flow of US\$0.7 million in Q4/2007**
- **Orad strengthened its position in the On-Air Graphic systems market with significant deals in 2007 with Deutsch Welle ,CCTV, Shanghai TV, Tele Madrid, Polsat, PCCW, RTBF, Canal+ and others**
- **Orad continued to dominate the virtual studios market with a contract worth US\$2.5 million with Canwest Global Communications**
- **A major share transaction between shareholders resulted in the sale of the**

**ISMM AG shares to the Edmond De Rothschild Israel Opportunity Fund LP and other US based funds**

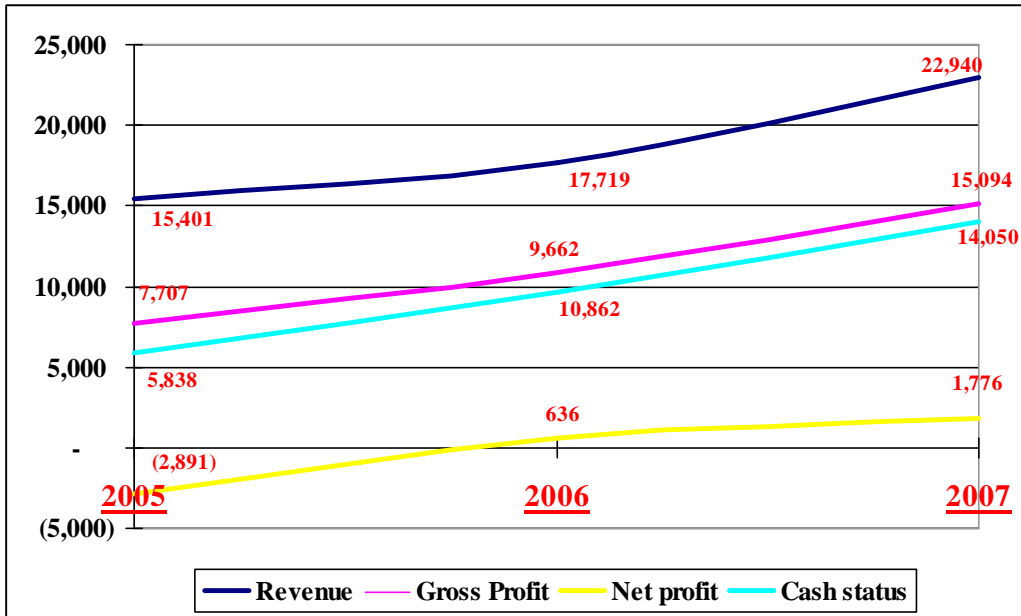
- **Orad strengthened its board of directors with the appointment of Joel Warschawski, President of Edmond de Rothschild Private Equity management Limited**

Avi Sharir, Orad’s President and Chief Executive Officer commented: “We are pleased with the results achieved for the year 2007. This is the third consecutive year of significant improvements in sales, gross margin, net profit and cash flow. Orad’s increased penetration of the On-Air graphic market contributed to the increase in sales and the increased gross margin.”, and added: "Orad offers today a one stop shop to prime broadcasters with a full suite of graphic systems, sports systems and virtual studios. This has resulted in more broadcasters choosing Orad's graphic systems. In 2007 we successfully increased our application offering. We deployed several integrated solutions to news-rooms as well as new applications in channel branding and sport solutions.”

He added: “We believe that Orad continues to dominate in the virtual studios market. In this regard we believe that Orad’s Proset solution represents the best technology available and offers a comprehensive solution to large networks wishing to adopt a cost saving solution. During the year, Orad received its largest ever Virtual Studio order from Canada’s largest network Canwest Global with a contract for a centralised virtual studio that controls multiple remote studios. Our strong order back log keeps us optimistic regarding the results for 2008”.

Financial summary for the relevant periods:

	<u>In thousand USD</u>				
	<u>Q4/06</u>	<u>Q3/07</u>	<u>Q4/07</u>	<u>2007</u>	<u>2006</u>
Sales	4,607	6,128	6,875	22,940	17,719
Gross Profit	2,916	3,918	4,353	15,094	10,818
Gross Margin	63.29%	64%	63%	66%	61.05%
R&D expenses	660	696	961	3,207	2,507
S&M Expenses	1,840	2,327	2,195	8,474	6,631
G&A expenses	362	498	663	2,207	1,506
Net Profit	185	621	706	1,775	636
Cash Status	9,662	13,306	14,050	14,050	9,662



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**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2007**

**U.S. DOLLARS IN THOUSANDS**

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**REPORT OF INDEPENDENT AUDITORS**

**To the Shareholders of**

**ORAD HI-TEC SYSTEMS LTD.**

We have audited the accompanying consolidated balance sheets of Orad Hi-Tec Systems Ltd. ("the Company") and its subsidiaries as of December 31, 2007 and 2006 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain wholly-owned subsidiary, whose assets constitute 3% of the total consolidated assets as of December 31, 2007 and 2006, respectively, and whose revenues constitute 4%, 2% and 3% of total consolidated revenues for the years ended December 31, 2007, 2006 and 2005, respectively. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to amounts included for those companies, is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2006 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

Tel-Aviv, Israel  
March 2, 2008

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

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

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

	<u>December 31,</u>	
	<u>2007</u>	<u>2006</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 12,981	\$ 9,091
Restricted cash	1,069	571
Trade receivables (net of allowance for doubtful accounts of \$ 117 and \$ 66 at December 31, 2007 and 2006, respectively)	1,869	2,422
Other accounts receivable and prepaid expenses	1,163	837
Inventories	2,920	2,696
Work in progress, net of advances from customers	78	520
<u>Total current assets</u>	<u>20,080</u>	<u>16,137</u>
SEVERANCE PAY FUND	1,343	1,017
PROPERTY AND EQUIPMENT, NET	1,753	1,530
<u>Total assets</u>	<u>\$ 23,176</u>	<u>\$ 18,684</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$ 2,115	\$ 1,354
Deferred revenues	2,280	1,841
Other accounts payable and accrued expenses	5,718	4,767
<u>Total current liabilities</u>	<u>10,113</u>	<u>7,962</u>
ACCRUED SEVERANCE PAY	1,950	1,503
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital:		
Ordinary shares of NIS 0.01 par value:		
Authorized - 27,000,000 shares as of December 31, 2006 and 2007;		
Issued and outstanding - 10,820,550 shares as of December 31, 2007 and 10,800,621 shares as of December 31, 2006		
	29	28
Additional paid-in capital	75,475	75,357
Foreign currency translation adjustments	(547)	(547)
Accumulated deficit	(63,844)	(65,619)
<u>Total shareholders' equity</u>	<u>11,113</u>	<u>9,219</u>
<u>Total liabilities and shareholders' equity</u>	<u>\$ 23,176</u>	<u>\$ 18,684</u>

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

March 2, 2008

Date of approval of the financial statements

Avi Sharir  
Director and  
Chief Executive Officer

Ehud Ben Yair  
Chief Financial Officer

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

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

	<u>Year ended December 31,</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Revenues:			
Sales	\$ 22,940	\$ 17,719	\$ 14,485
Long-term development contracts	<u>-</u>	<u>-</u>	<u>916</u>
<u>Total</u> revenues	<u>22,940</u>	<u>17,719</u>	<u>15,401</u>
Cost of revenues:			
Cost of sales	7,846	6,901	6,646
Cost of long-term development contracts	<u>-</u>	<u>-</u>	<u>1,047</u>
<u>Total</u> cost of revenues	<u>7,846</u>	<u>6,901</u>	<u>7,693</u>
Gross profit	<u>15,094</u>	<u>10,818</u>	<u>7,708</u>
Operating expenses:			
Research and development, net	3,207	2,507	2,451
Sales and marketing	8,474	6,631	6,078
General and administrative	<u>2,207</u>	<u>1,506</u>	<u>1,754</u>
<u>Total</u> operating expenses	<u>13,888</u>	<u>10,644</u>	<u>10,283</u>
Operating income (loss)	1,206	174	(2,575)
Financial income (expenses), net	573	467	(316)
Other expenses, net	<u>(4)</u>	<u>(5)</u>	<u>-</u>
Net income (loss)	<u>\$ 1,775</u>	<u>\$ 636</u>	<u>\$ (2,891)</u>
Basic net earnings (loss) per share	<u>\$ 0.16</u>	<u>\$ 0.06</u>	<u>\$ (0.27)</u>
Weighted average number of shares used in computing basic net earnings (loss) per share (in thousands)	<u>10,821</u>	<u>10,791</u>	<u>10,781</u>
Diluted net earnings (loss) per share	<u>\$ 0.16</u>	<u>\$ 0.06</u>	<u>\$(0.27)</u>
Weighted average number of shares used in computing diluted net earnings (loss) per share (in thousands)	<u>10,934</u>	<u>10,823</u>	<u>10,781</u>

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

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

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

	<b>Number of outstanding Ordinary shares</b>	<b>Share capital</b>	<b>Additional paid-in capital</b>	<b>Foreign currency translation adjustments</b>	<b>Accumulated deficit</b>	<b>Total</b>
Balance as of January 1, 2005	10,750,726	\$ 28	\$ 75,241	\$ (547)	\$ (63,364)	\$ 11,358
Comprehensive loss:						
Net loss	-	-	-	-	(2,891)	(2,891)
Issuance of shares upon exercise of employee share options	11,250	*) -	9	-	-	9
Issuance of earn-out shares	<u>28,645</u>	*) -	<u>31</u>	-	-	<u>31</u>
Balance as of December 31, 2005	10,790,621	28	75,281	(547)	(66,255)	8,507
Comprehensive income:						
Net income	-	-	-	-	636	636
Issuance of shares upon exercise of employee share options	10,000	*) -	9	-	-	9
Share-based compensation	<u>-</u>	<u>-</u>	<u>67</u>	<u>-</u>	<u>-</u>	<u>67</u>
Balance as of December 31, 2006	10,800,621	28	75,357	(547)	(65,619)	9,219
Comprehensive income:						
Net income	-	-	-	-	1,775	1,775
Issuance of shares upon exercise of employee share options	19,929	1	22	-	-	23
Share-based compensation	<u>-</u>	<u>-</u>	<u>96</u>	<u>-</u>	<u>-</u>	<u>96</u>
Balance as of December 31, 2007	<u>10,820,550</u>	<u>\$ 29</u>	<u>\$ 75,475</u>	<u>\$ (547)</u>	<u>\$ (63,844)</u>	<u>\$ 11,113</u>

\*) Represents an amount lower than \$ 1.

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



**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

U.S. dollars in thousands

	<b>Year ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
<u>Cash flows from operating activities:</u>			
Net income (loss)	\$ 1,775	\$ 636	\$ (2,891)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation	545	569	623
Share-based compensation	96	67	-
Decrease in trade receivables, net and other accounts receivable and prepaid expenses	227	1,214	591
Decrease (increase) in inventories	(384)	29	591
Decrease in work in progress, net of advances from customers	442	22	597
Increase in trade payables, other accounts payable and accrued expenses and accrued severance pay, net	1,833	731	429
Increase in deferred revenues	439	640	460
Other	-	5	31
Net cash provided by operating activities	<u>4,973</u>	<u>3,913</u>	<u>431</u>
<u>Cash flows from investing activities:</u>			
Purchase of property and equipment	(656)	(146)	(231)
Proceeds from sale of property and equipment	48	48	127
Decrease (increase) in restricted cash	<u>(498)</u>	<u>(71)</u>	<u>250</u>
Net cash provided by (used in) investing activities	<u>(1,106)</u>	<u>(169)</u>	<u>146</u>
<u>Cash flows from financing activities:</u>			
Issuance of shares upon exercise of employee share options	<u>23</u>	<u>9</u>	<u>9</u>
Net cash provided by financing activities	<u>23</u>	<u>9</u>	<u>9</u>
Increase in cash and cash equivalents	3,890	3,753	586
Cash and cash equivalents at beginning of year	<u>9,091</u>	<u>5,338</u>	<u>4,752</u>
Cash and cash equivalents at end of year	<u>\$ 12,981</u>	<u>\$ 9,091</u>	<u>\$ 5,338</u>

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

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands**

**NOTE 1:- GENERAL**

- a. Orad Hi-Tec Systems Ltd. ("the Company") was incorporated in 1993. The Company and its subsidiaries provide innovative real-time video processing technologies for TV broadcasting, production studio and sports events. The Company also develops and markets high-end three dimensional graphical computer platforms for the visual simulation and virtual reality markets.

The Company operates through its wholly-owned subsidiaries in the United States, France, Poland, Germany, the Netherlands, the United Kingdom, Spain, Israel and Hong-Kong. These subsidiaries are engaged in the development, selling and marketing of the Company's products. The Company sells its products directly and through its subsidiaries and its distribution networks worldwide.

- b. The Company reclassified certain overhead expenses in the prior years' statements of operations. The following reclassifications, which conform to the current years allocation of these overhead expenses had no effect on the reported operating loss, net loss, basic and diluted loss per share and shareholders equity.

	<b>Year ended December 31, 2005</b>		
	<b>As previously reported</b>	<b>Reclassification</b>	<b>As currently reported</b>
Cost of revenues:			
Cost of sales	5,287	1,359	6,646
Cost of long-term development contracts	1,047	-	1,047
<u>Total cost of revenues</u>	<u>6,334</u>	<u>1,359</u>	<u>7,693</u>
Gross profit	9,067	(1,359)	7,708
Operating expenses:			
Research and development, net	2,300	151	2,451
Sales and marketing	6,813	(735)	6,078
General and administrative	2,529	(775)	1,754
<u>Total operating expenses</u>	<u>11,642</u>	<u>(1,359)</u>	<u>10,283</u>
<u>Operating loss</u>	<u>2,575</u>	<u>-</u>	<u>2,575</u>

## ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

#### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") including relevant interpretations of the U.S. Securities and Exchange Commission.

a. Use of estimates:

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

b. Financial statements in U.S. dollars:

A substantial portion of the revenues of the Company and its subsidiaries is generated in U.S. dollars ("dollar"). In addition, a substantial portion of the Company's and its subsidiaries' costs is incurred in dollars. A substantial portion of the Company's funds is held in U.S. dollars. The Company's management believes that the dollar is the currency of the primary economic environment in which the Company and its subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the US dollar.

Accordingly, monetary assets, and liabilities and transactions in currencies other than the dollar are remeasured into U.S. dollars in accordance with Statement of Financial Accounting Standards No. 52, "Foreign Currency Translation" ("SFAS No. 52"). All transactions gains and losses from the remeasurement are reflected in the consolidated statements of operations as financial income or expenses, as appropriate.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany balances and transactions have been eliminated upon consolidation.

d. Cash equivalents:

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

e. Restricted cash:

Restricted cash is primarily invested in highly liquid deposits, which are used as a security for sales agreements and office lease agreements.

f. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs are provided to cover risks arising from slow-moving items, technological obsolescence and excess inventories.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**U.S. dollars in thousands**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Cost is determined as follows:

Raw materials, parts and supplies - by the moving average method.

Products in process and finished products:

Raw materials, parts and supplies - by the moving average method.

Subcontracting costs - on the basis of actual costs.

g. Property and equipment:

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

	<u>%</u>
Computers , software and peripheral equipment	20 - 33
Office furniture and equipment	6 - 15
Motor vehicles	15
Leasehold improvements	Over the shorter of the term of the lease or the life of the asset

The Company leases under operating leases computers and peripheral equipment, mobile broadcasting and demonstrating units ("leased equipment") to its customers. Leased equipment is stated at cost, net of accumulated depreciation. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets (three years).

h. Impairment of long-lived assets:

The Company's and its subsidiaries' long-lived assets are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2007, no impairment losses have been identified.

i. Revenue recognition:

The Company and its subsidiaries generate revenues mainly from sales of systems, software licenses, development contracts and from operating leases of equipment.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**U.S. dollars in thousands**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The Company and its subsidiaries implement Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP No. 97-2"), as amended. Revenues from systems sales are recognized upon delivery of the system or upon installation at the customer site, where applicable, provided that collection is probable, the system fee is fixed or determinable and persuasive evidence of an arrangement exists. In cases where a significant installation is required after the delivery of the system, revenues from the system are deferred until the installation occurs. Revenues in arrangements with multiple deliverables are recognized under the "residual method" when Vendor specific Objective Evidence ("VSOE") of fair value exists for all undelivered elements, no VSOE exists for the delivered elements, and all other revenue recognition criteria are satisfied. Revenues from training and installation included in multiple element arrangements are recognized at the time they are rendered.

Revenues from development contracts are recognized based on SOP No. 81-1, "Accounting for Performance of Construction Type and Certain Production Type Contracts", using contract accounting on the completed-contract method or when applicable, as specific milestones are met. A provision for estimated losses on uncompleted contracts is recorded in the period in which such losses are first identified, in the amount of the estimated loss on the entire contract.

Revenues from operating leases of equipment are recognized ratably over the lease period, in accordance with Statement of Financial Accounting Standards No. 13, "Accounting for Leases" ("SFAS No. 13").

The Company and its subsidiaries generally do not grant a right of return to their customers.

Deferred revenue includes amounts received from customers but not recognized as revenues.

j. Warranty costs:

The Company offers a one year warranty for all of its systems. Provision for warranty costs is provided at the time revenues are recognized, for estimated material costs during the warranty period based on the Company's experience.

k. Research and development costs:

Research and development costs are charged to the statement of operations as incurred.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**U.S. dollars in thousands**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

**l. Non-royalty-bearing grants:**

Non-royalty-bearing grants from the European Union for funding of approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the costs incurred. These grants are presented as a reduction of research and development expenses. During the years 2007, 2006, 2005, the Company received grants in the amount of \$141, \$ 163 and \$ 141, respectively.

**m. Royalty-bearing grants:**

Royalty-bearing grants from the Government of Israel for funding of approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the costs incurred. These grants are presented as a reduction of research and development expenses. During the years 2007, 2006, 2005, no development grants were received.

**n. Income taxes:**

The Company and its subsidiaries account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This Statement prescribes the use of the liability method whereby deferred tax assets and liabilities are determined based on the differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

**SFAS 109**

On January 1, 2007, the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" (FIN 48). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. The Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The audits of the tax years 2002 and 2005 have been completed, but are still pending review by the Israeli tax authorities. The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**U.S. dollars in thousands**

o. Concentrations of credit risks:

Financial instruments that potentially subject the Company and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents, restricted cash, work in progress, net of advances from customers and trade receivables.

Cash and cash equivalents and restricted cash are mainly invested in U.S. dollars with major banks in Cayman and in Israel. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

Work in progress, net of advances from customers is derived from long term development contracts. The Company performs ongoing credit evaluations of its customers. A provision for estimated losses on uncompleted contracts is recorded in the period in which such losses are first identified, in the amount of the estimated loss on the entire contract.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**U.S. dollars in thousands**

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

Trade receivables are mainly derived from sales to customers located primarily in Europe, Asia, North America and South America. The Company performs ongoing credit evaluations of its customers. An allowance for doubtful accounts is determined with respect to those amounts that the Company and its subsidiaries have determined to be doubtful of collection.

As of December 31, 2007 and 2006, the Company and its subsidiaries have no significant off-balance-sheet concentration of credit risk such as forward exchange contracts, option contracts or other foreign hedging arrangements.

p. Severance pay:

The Company's liability for severance pay for its Israeli employees is calculated pursuant to the Israeli Severance Pay Law based on the most recent salary of the employees multiplied by the number of years of employment, as of the balance sheet date. Employees are entitled to one month's salary for each year of employment or a portion thereof.

The Company's liability for all of its employees is fully provided by monthly deposits with insurance policies deposited funds and by an accrual.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli Severance Pay Law or labor agreements. The value of the deposited funds is based on the cash surrendered value of the insurance policies.

Severance expenses for the years ended December 31, 2007 and 2006 amounted to approximately \$ 367 and \$ 313, respectively.

q. Net earnings (loss) per share:

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

r. Fair value of financial instruments:

The carrying amounts of cash and cash equivalents, restricted cash, trade receivables, other accounts receivable and prepaid expenses, trade payables and other accounts payable and accrued expenses approximate their fair value due to the short-term maturity of such instruments.



**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

- s. Accounting for share-based compensation:

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)") which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors. SFAS 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

SFAS 123(R) requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in the Company's consolidated income statement. Prior to the adoption of SFAS 123(R), the Company accounted for equity-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123").

The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard starting from January 1, 2006, the first day of the Company's fiscal year 2006. Under that transition method, compensation cost recognized in the year ended December 31, 2006, includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The Company recognizes compensation expenses for the value of its awards, which have graded vesting, based on the straight line method over the requisite service period of each of the awards, net of estimated forfeitures. Estimated forfeitures are based on actual historical pre-vesting forfeitures.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company's net income for the years ended December 31, 2007 and 2006, is approximately \$ 86 and \$ 67, respectively, lower than if it had continued to account for stock-based compensation under APB 25. Basic and diluted net earnings per share for the years ended December 31, 2006 and 2007, are \$ 0.01 lower than if the Company had continued to account for share-based compensation under APB 25.

Prior to January 1, 2006, the Company applied the intrinsic value method of accounting for stock options as prescribed by APB 25, whereby compensation expense is equal to the excess, if any, of the quoted market price of the stock over the exercise price at the grant date of the award.

In 1996, the Company approved an employee share option plan, which was expanded in 2000 and 2002 ("the 1996 Share Option Plan"). Under the expanded plan, 974,465 options to purchase Ordinary shares have been reserved for issuance. These options may be granted to directors, officers and employees of the Company and its subsidiaries.

Any options, which are canceled or forfeited before expiration, become available for future grants.

During 2003, the Company approved a new share option plan ("the 2003 Share Option Plan"). The Company's Board of Directors approved treating shares allotted under the 1996 Share Option Plan as being reserved for allotment under the 2003 Share Option Plan.

Options granted in 2007 are vested as follows: 25% after the first year, 25% after the second year, 25% after the third year and 25% after the fourth year starting from the date of grant. If not exercised, the options will expire on the sixth anniversary of the date of the grant.

Total number of options available for future grants as of December 31, 2007 amounted to 16,125.

The Company estimates the fair value of stock options granted using the Black-Scholes-Merton option-pricing model. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility and the expected option term. Expected volatility was calculated based upon actual historical stock price movements.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The expected option term represents the period that the Company's stock options are expected to be outstanding and was determined based on the simplified method permitted by SAB 107 as the average of the vesting period and the contractual term. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value of the Company's stock options granted to employees and directors for the years ended December 31, 2007 and 2006 was estimated using the following weighted average assumptions:

	<b>Year ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Risk free interest	4.38%	4.89%
Dividend yields	0%	0%
Volatility	75%	66%
Expected term (in years)	4.24	4.25

During the years ended December 31, 2007 and 2006, the Company recognized stock-based compensation expenses related to employee stock options in the amount of \$ 86 and \$ 67, respectively.

A summary of the Company's options activity, and related information is as follows:

	<b>Number of options</b>	<b>Weighted average exercise price</b>	<b>Weighted average remaining contractual term (in years)</b>	<b>Aggregate intrinsic value (in thousands)</b>
Outstanding at beginning of year	672,454	\$ 6.18		
Granted	158,500	\$ 2.86		
Exercised	19,930	\$ 1.14		
Expired or forfeited	27,149	\$ 5.44		
Outstanding at end of year	783,875	\$ 5.66	4.46	\$ 1,297
Exercisable at end of year	425,792	\$ 8.54	3.9	\$ 686
Vested and expected to vest at end of year	783,875	\$ 5.66	4.46	\$ 1,297

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The weighted-average grant-date fair value of options granted during the years ended December 31, 2007 and 2006 was \$ 1.73 and \$ 0.99, respectively. The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the Company's closing stock price on the last trading day of the fourth quarter of fiscal 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2007. This amount changes based on the fair market value of the Company's stock.

Total intrinsic value of options exercised for the year ended December 31, 2007 was approximately \$ 68. As of December 31, 2007, there was approximately \$ 417 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's stock option plans. That cost is expected to be recognized over a weighted-average period of 5.23 years. Total grant-date fair value of vested options vested for the year ended December 31, 2007 was approximately \$ 92.

The following table summarizes information about options outstanding and exercisable as of December 31, 2007:

Range of exercise price	Options outstanding as of December 31, 2007	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable as of December 31, 2007	Weighted average exercise price of options exercisable
\$0.80 - 1.19	114,321	5.80	\$ 1.00	101,821	\$ 0.98
\$1.28 - 1.90	315,000	4.28	\$ 1.78	127,917	\$ 1.76
\$2.14 - 3.06	221,714	5.50	\$ 2.69	68,214	\$ 2.41
\$ 4.6	5,000	5.37	\$ 4.60	-	\$ 4.60
\$9.08 - 11.71	25,122	1.31	\$ 11.05	25,122	\$ 11.05
\$ 20.71	49,218	1.92	\$ 20.71	49,218	\$ 20.71
\$ 33.18 - 34.95	53,500	2.13	\$ 34.60	53,500	\$ 34.60
	<u>783,875</u>	4.46	<u>\$ 5.66</u>	<u>425,792</u>	<u>\$ 8.54</u>

All of the options granted to employees officers and directors in 2006 and 2007, have an exercise price equal to the fair market value of the share at date of grant.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The pro-forma table below illustrates the effect on the net income (loss) and net earnings (loss) per share for the year ended December 31, 2005, assuming that the Company had applied the fair value recognition provision of SFAS 123 on its stock-based employee compensation:

	<b>Year ended December 31, 2005</b>
Net loss as reported	\$ (2,891)
Add: share-based compensation expense included in reported net loss	-
Deduct: share-based compensation expense determined under fair value method	(63)
Pro forma net loss	\$ (2,954)
Basic and diluted net loss per share as reported	\$ (0.27)
Pro forma basic and diluted net loss per share	\$ (0.27)

For the purposes of pro-forma disclosures, stock-based compensation is amortized over the vesting period using the straight line method.

t. Impact of recently issued accounting standards:

SFAS 159-

On February 15, 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). Under this Standard, the Company may elect to report financial instruments and certain other items at fair value on a contract-by-contract basis with changes in value reported in earnings. This election is irrevocable. SFAS 159 provides an opportunity to mitigate volatility in reported earnings that is caused by measuring hedged assets and liabilities that were previously required to use a different accounting method than the related hedging contracts when the complex provisions of SFAS 133 hedge accounting are not met.

SFAS 159 is effective for years beginning after November 15, 2007. Early adoption within 120 days of the beginning of the Company's 2007 fiscal year is permissible, provided the Company has not yet issued interim financial statements for 2007 and has adopted SFAS 157. The Company is currently evaluating the impact of adopting SFAS 159 on its financial position, cash flows, and results of operations.

## ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

##### SFAS 157

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("Statement No. 157") which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement No. 157 applies to other accounting pronouncements that require or permit fair value measurements and, accordingly, does not require any new fair value measurements. Statement No. 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis, and should be applied prospectively. The adoption of the provisions of Statement No. 157 related to financial assets and liabilities and other assets and liabilities that are carried at fair value on a recurring basis is not anticipated to materially impact the company's consolidated financial position and results of operations. Subsequently, the FASB provided for a one-year deferral of the provisions of Statement No. 157 for non-financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a non-recurring basis. The company is currently evaluating the impact of adopting the provisions of Statement No. 157 for non-financial assets and liabilities that are recognized or disclosed on a non-recurring basis.

##### SFAS 141(R)

In December 2007, the FASB issued SFAS 141(R), *Business Combinations*. This Statement replaces SFAS 141, *Business Combinations*, and requires an acquirer to recognize the assets acquired, the liabilities assumed, including those arising from contractual contingencies, any contingent consideration, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the statement. SFAS 141(R) also requires the acquirer in a business combination achieved in stages (sometimes referred to as a step acquisition) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with SFAS 141(R)). In addition, SFAS 141(R)'s requirement to measure the noncontrolling interest in the acquiree at fair value will result in recognizing the goodwill attributable to the noncontrolling interest in addition to that attributable to the acquirer. SFAS 141(R) amends SFAS No. 109, *Accounting for Income Taxes*, to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. It also amends SFAS 142, *Goodwill and Other Intangible Assets*, to, among other things, provide guidance on the impairment testing of acquired research and development intangible assets and assets that the acquirer intends not to use.

SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We are currently assessing the potential impact that the adoption of SFAS 141(R) could have on our financial statements.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

SFAS 160

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS 160 amends Accounting Research Bulletin 51, *Consolidated Financial Statements*, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It also clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also changes the way the consolidated income statement is presented by requiring consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent owners and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008. We are currently assessing the potential impact that the adoption of SFAS 141(R) could have on our financial statements.

SAB 110

On December 21, 2007 the SEC staff issued Staff Accounting Bulletin No. 110 (SAB 110), which, effective January 1, 2008, amends and replaces SAB 107, Share-Based Payment. SAB 110 expresses the views of the SEC staff regarding the use of a “simplified” method in developing an estimate of expected term of “plain vanilla” share options in accordance with FASB Statement No. 123(R), Share-Based Payment. Under the “simplified” method, the expected term is calculated as the midpoint between the vesting date and the end of the contractual term of the option.

The use of the “simplified” method, which was first described in Staff Accounting Bulletin No. 107, was scheduled to expire on December 31, 2007. SAB 110 extends the use of the “simplified” method for “plain vanilla” awards in certain situations. The SEC staff does not expect the “simplified” method to be used when sufficient information regarding exercise behavior, such as historical exercise data or exercise information from external sources, becomes available.

**NOTE 3: - OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES**

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Government authorities	\$ 583	\$ 386
Prepaid expenses	330	271
Other	250	180
	<b>\$ 1,163</b>	<b>\$ 837</b>

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 4:- INVENTORIES**

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Raw materials	\$ 583	\$ 697
Products in process and finished products	2,337	1,999
	<b>\$ 2,920</b>	<b>\$ 2,696</b>

Inventory write-off provision expense recorded in 2007, 2006 and 2006 amounted to \$ 440, \$ 219 and \$ 469, respectively. The write-offs are included in cost of revenues.

**NOTE 5:- WORK IN PROGRESS, NET OF ADVANCES FROM CUSTOMERS**

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Work in progress	\$ 1,986	\$ 1,977
Advances from customers	(1,308)	(1,257)
Provision for future estimated expenses	(600)	(200)
	<b>\$ 78</b>	<b>\$ 520</b>



**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 6:- PROPERTY AND EQUIPMENT**

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Cost:		
Computers and peripheral equipment	\$ 8,201	\$ 7,688
Office furniture and equipment	362	358
Motor vehicles	71	88
Leasehold improvements	2,361	2,347
	10,995	10,481
Accumulated depreciation:		
Computers and peripheral equipment	7,301	7,232
Office furniture and equipment	234	222
Motor vehicles	63	58
Leasehold improvements	1,643	1,439
	9,241	8,951
Depreciated cost	\$ 1,754	\$ 1,530

Depreciation expense amounted to \$ 568, \$ 569 and \$ 623 for the years ended December 31, 2007, 2006 and 2005, respectively.

**NOTE 7:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Employees and payroll accruals	\$ 1,185	\$ 897
Accrued expenses	3,991	3,378
Government authorities	170	124
Warranty provision	286	315
Other	86	53
	\$ 5,718	\$ 4,767

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 8:- COMMITMENTS AND CONTINGENT LIABILITIES**

a. Royalty commitments:

1. Royalties to the Office of the Chief Scientist ("the OCS"):

Under the Company's research and development agreements with the OCS and pursuant to applicable laws, the Company is required to pay royalties at the rate of 3.5% of sales of products developed with funds provided by the OCS, up to an amount equal to 100% of the OCS research and development grants received, linked to the dollar. The Company is obligated to repay the Israeli Government for the grants received only to the extent that there are sales of the funded products.

Royalty expenses amounted to \$ 214, \$ 276 and \$ 217 for the years ended December 31, 2007, 2006 and 2005, respectively, relating to the accrual and repayment of such grants.

As of December 31, 2007, the Company had a contingent obligation to pay royalties in the amount of \$ 2,084.

2. Royalty obligation to the Marketing Fund of the Government of Israel:

The Israeli Government, through the Fund for the Encouragement of Marketing Activities, awarded the Company grants for participation in foreign marketing expenses. The Company is committed to pay royalties at the rate of 4% of the increase in foreign sales, up to an amount equal to 100% of the grant received plus interest.

Royalties' expenses amounted to \$ 149, \$ 182 and \$ 194 for the years ended December 31, 2007, 2006 and 2005, respectively, relating to the repayment of such grants.

As of December 31, 2007, the Company had no any contingent obligation to pay royalties, in excess of amounts accrued.

b. Operating leases:

The Company and its subsidiaries lease their facilities under various operating lease agreements, which expire on various dates. Aggregate minimum rental commitments under non-cancelable leases as of December 31, 2007, are as follows:

2008	\$	551
2009		490
2010		433
2011 and thereafter		616
		<hr/>
	\$	2,090

Total rental expense for the years ended December 31, 2007, 2006 and 2005, amounted to \$ 556, \$ 546 and \$ 565, respectively.

**ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

c. Liens:

As of December 31, 2007, fixed pledges on cash deposits in the amount of \$ 272 were recorded to secure office lease agreements. The company has also secured cash deposits in the amount of \$ 797 against bank guaranties to secure sales agreements.

d. Litigation:

As of the date of the financial reports, no Claims have been lodged against the Company.

**NOTE 9:- SHAREHOLDERS' EQUITY**

The Company's shares are listed for trading on the Frankfurt Stock Exchange (Prime Standard) and on the Alternative Investment Market ("AIM") in the London Stock Exchange, both under the symbol "OHT".

a. Ordinary shares:

Ordinary shares confer upon their holders voting rights, the right to receive cash dividends, and the right to a share in excess assets upon liquidation of the Company.

b. Employee share option plan:

See detailed information in Note 2s.

c. Acquisition of Art Technologies GmbH ("Art"):

According to the purchase agreement with Art, the issuance of 57,290 Ordinary shares was conditional upon achieving certain revenue targets from the product developed by Art ("contingent shares"). During 2002, upon achievement of certain of the revenue targets, 28,645 of the contingent shares with a fair value of \$ 54 were issued. During 2003 and 2004, certain of the revenue targets were not achieved in the prescribed time frame and therefore, the remaining 28,645 shares were not issued. However, the Company agreed to issue such shares during 2005, and accordingly, the remaining 28,645 shares with a fair value of \$ 31 were issued.

d. Dividends:

Dividends, if any, will be paid in New Israeli Shekels ("NIS"). Dividends paid to shareholders outside Israel may be converted to U.S. dollars on the basis of the exchange rate prevailing at the date of the conversion. The Company does not intend to pay cash dividends in the foreseeable future.

## ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands

#### NOTE 10:- INCOME TAXES

a. Domestic - Israeli income taxes:

1. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes are measured in terms of earnings in NIS after certain adjustments for increases in the Israeli Consumer Price Index ("CPI"). As explained in Note 2b, the financial statements are measured in U.S. dollars. The difference between the annual change in the Israeli CPI and in the NIS/dollar exchange rate causes a further difference between taxable income and the income before taxes shown in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the difference between the functional currency and the tax basis of assets and liabilities.

2. Tax rates:

On July 25, 2005, the Knesset (Israeli Parliament) approved the Law for the Amendment of the Income Tax Ordinance (No. 147), 2005, which prescribes, among others, a gradual decrease in the corporate tax rate in Israel to the following tax rates: in 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%. The amendment is not expected to have a material effect on the Company's financial position and results of operations.

3. Tax benefits under the Law for the Encouragement of Capital Investments, 1959:

The Company's production facilities in Israel have been granted an "Approved Enterprise" status under the above law. Four expansion programs of the Company have been granted the status of an "Approved Enterprise". According to the provisions of such Israeli law, the Company has been granted an "Alternative Benefit" status, under which the main benefits are tax exemption and a reduced tax rate. Consequently, the Company's income derived from the "Approved Enterprise" is tax exempt for a period of two years and for an additional period of five to eight years is subject to a reduced tax rate of 10% - 25% (based on the percentage of foreign ownership in each taxable year).

The Company completed implementation of its first, second and third expansion programs in 1996, 1999 and in 2000, respectively. The fourth program has not yet been completed.

The period of tax benefits, detailed above, is subject to limits of the earlier of 12 years from the commencement of production, or 14 years from the approval date.

**NOTE 10:- INCOME TAXES (Cont.)**

The entitlement to the above benefits is conditional upon the fulfillment of the conditions stipulated by the above law, regulations published thereunder and the instruments of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest.

If the retained tax-exempt profits are distributed, they would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative system of benefits, currently 20%-25% for an "Approved Enterprise". As of December 31, 2007, accumulated deficit included approximately \$ 6,721 of tax exempt profits earned by the Company's "Approved Enterprises". The Company has decided not to distribute dividends out of such tax-exempt profits. Accordingly, no deferred income taxes have been provided on income attributable to the Company's "Approved Enterprise".

Income from sources other than the "Approved Enterprise" during the benefit period will be subject to the tax at the regular rate.

b. Tax assessments:

The Company has obtained final tax assessments from the Israeli Tax Authorities for the tax years through 2002.

c. Stamp duty:

An amendment of the Stamp Duty on Documents Law, 1961, or the Stamp Duty Law, came into effect on June 1, 2003 determining, among other things, that the Stamp Duty on most agreements shall be paid by the parties that signed such agreement, jointly or severally, or by the party that undertook under such agreement to pay the Stamp Duty. The Stamp Duty Law determined that a document (or part thereof) that is signed in Israel or relates to an asset or obligation in Israel would be subject to a tax rate between 0.4% and 1% of the value of the subject matter of such document.

Under an order published in December 2005, the requirements to pay Stamp Duty were cancelled with respect to documents signed on or after January 1, 2006.

**NOTE 10:- INCOME TAXES (Cont.)**

During 2006, based on the opinion of its legal counsel, the Company's management decided to reduce a previously recorded accrual by approximately \$ 75 (reduction of general and administrative expenses).

d. Net operating carry forward losses:

The Company has accumulated losses for tax purposes as of December 31, 2007, in the amount of approximately \$ 16,147 which may be carried forward and offset against taxable income in the future for an indefinite period.

The carry forward losses of the Israeli subsidiary, amounting to approximately \$ 800.

Foreign:

The carry forward losses of the French subsidiary, amounting to approximately \$ 15,800, which may be carried forward and offset against taxable income in the future, for an indefinite period.

The carry forward losses of the U.S. subsidiary, amounting to approximately \$ 9,940 as of December 31, 2007, can be utilized mainly from 2017 to 2028. Utilization of U.S. net operating losses may be subject to the substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

The carry forward losses of the Dutch subsidiary, amounting to approximately \$ 5,880 as of December 31, 2007, can be utilized indefinitely.

The carry forward losses of the other subsidiaries amount to approximately \$ 4,600 as of December 31, 2007. The majority of these carry forward losses can be utilized indefinitely.

**NOTE 10:- INCOME TAXES (Cont.)**

## e. Deferred income taxes:

Management currently believes that since the Company and its subsidiaries have a history of losses it is more likely than not that the deferred tax assets regarding the loss carryforwards will not be realized in the foreseeable future.

## f. Reconciliation of the theoretical tax expense (benefit) to the actual tax expense (benefit):

In 2007, 2006 and 2006, the main reconciling items between the statutory tax rate of the Company and the effective tax rate (0%) are carryforward tax losses, for which a full valuation allowance was provided.

## g. Net income (loss) is comprised of the following:

	<b>Year ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
		\$ 2,972	
Domestic	\$ 4,701		\$ (2,031)
Foreign	(2,926)	(2,336)	(860)
	<u>\$ 1,775</u>	<u>\$ 636</u>	<u>\$ (2,891)</u>

**NOTE 11:- GEOGRAPHIC INFORMATION**

The Company manages its business on the basis of one reportable segment.

## a. Revenues classified by geographic destinations based on customer locations:

	<b>Year ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Europe	\$ 12,913	\$ 9,930	\$ 8,239
Asia	3,465	3,969	3,844
North America	1,263	473	1,234
South America	4,233	2,848	1,836
Other	1,066	499	248
	<u>\$ 22,940</u>	<u>\$ 17,719</u>	<u>\$ 15,401</u>

b. Long-lived assets by geographic region:

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Israel	\$ 1,421	\$ 1,222
Europe	208	255
South America	67	27
North America	18	6
Other	39	20
	<u>\$ 1,753</u>	<u>\$ 1,530</u>

Formatiert: Englisch  
(Großbritannien)



**NOTE 12:- FINANCIAL INCOME (EXPENSES), NET**

	<b>Year ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Financial income:			
Foreign currency translation adjustments, net	\$ 295	\$ 244	\$ -
Interest on bank deposits	484	358	108
	<u>779</u>	<u>602</u>	<u>108</u>
Financial expenses:			
Foreign currency transaction adjustments, net		-	(379)
Bank charges	(124)	(78)	(45)
Interest on short-term bank credit	(82)	(57)	-
	<u>(206)</u>	<u>(135)</u>	<u>(424)</u>
	<u>\$ 573</u>	<u>\$ 467</u>	<u>\$ (316)</u>

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