



## **Orad Hi-Tec Systems Ltd ('Orad' oder 'das Unternehmen')**

### **Rekordergebnisse für das Geschäftsjahr 2008 sowie das 4. Quartal 2008**

**Tel Aviv, 23. Februar 2009** – Die Orad Hi-Tec Systems Ltd. (ISIN IL0010838071; Symbol: OHT), ein führender Anbieter von TV-Produktions- und virtuellen Grafiklösungen, hat im Geschäftsjahr 2008 sowie im 4. Quartal 2008 ein Rekordergebnis verzeichnet.

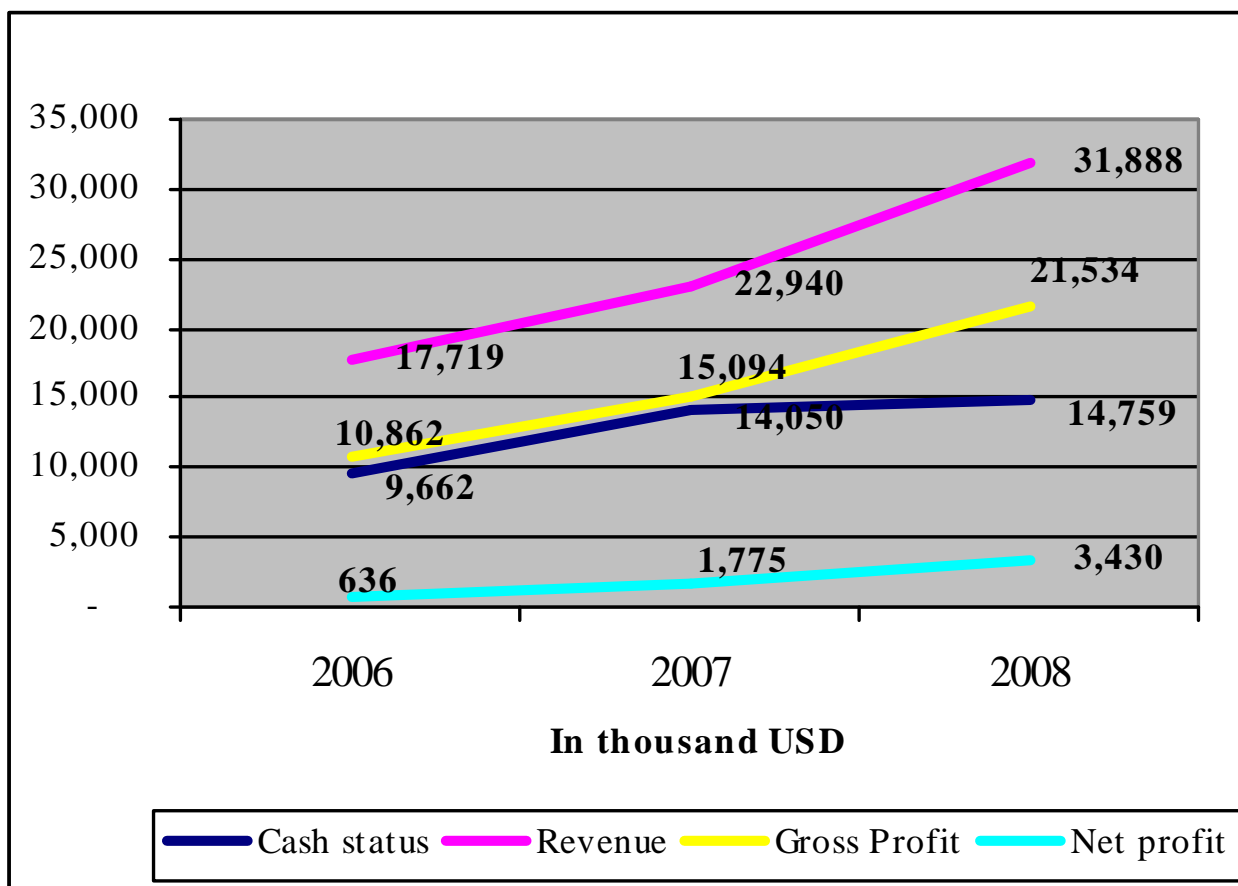
#### **Highlights:**

- **Umsatzsteigerung in 2008 um 39% auf USD 31,9 Mio. verglichen mit USD 22,9 Mio. in 2007**
- **Umsätze im 4. Quartal 2008 erhöhten sich um 16 % auf USD 8 Mio. im Vergleich zu USD 6,9 Mio. im 4. Quartal 2007**
- **Rohertragsmarge für 2008 auf 68 % gesteigert gegenüber 66 % in 2007**
- **Jahresüberschuss verbesserte sich überproportional um 93 % auf USD 3,4 Mio. verglichen mit USD 1,8 Mio. im Vorjahr**
- **Liquide Mittel erhöhten sich auf USD 14,8 Mio.**
- **Orad setzte seinen Wachstumskurs im On-Air-Grafik Segment mit neuen Aufträgen der Deutschen Welle, des chinesischen CCTV, des TV Record aus Brasilien sowie des tschechischen Fernsehens fort.**
- **In 2008 unterzeichnete Orad mehrere umfangreiche Verträge über das Orad Sports System mit der Niederländischen und der Französischen Fußball-Liga, mit dem chinesischen CCTV für die Produktion der Olympischen Spiele sowie mit dem kanadischen RDS.**

Avi Sharir, CEO und Präsident von Orad: „Wir sind mit den Ergebnissen des Jahres 2008 zufrieden. Es

ist das vierte Jahr in Folge mit deutlichen Verbesserungen bei Umsatz, Rohertragsmarge, Jahresüberschuss und Cashflow. Orads bessere Marktdurchdringung bei On-Air-Grafik Systemen trug zum Anstieg beim Umsatz und zur gestiegenen Rohertragsmarge bei.“ Weiter führte Avi Sharir aus: „Wir sind in der Lage, umfassende Grafiklösungen, die sich zudem durch hohe Zuverlässigkeit auszeichnen, anzubieten. Dies ermöglicht uns die Verbreiterung unseres Kundenstammes. In 2008 war deutlich die Nachfrage nach kostensparenden Lösungen im High-end-Markt zu spüren. Diese Nachfrage machte es uns möglich, den Verkauf von Virtual-Studio-Lösungen in allen Regionen zu steigern. Orad hat auch damit begonnen, den Markt der mittelgroßen TV-Sendeanstalten zu durchdringen. So wurde diesen Sendern die „Morpho“-Solution angeboten, die beim Einsatz des 2D/3D-Schrift-Generators ausgesprochen bedienungsfreundlich ist. Die gesamte Branche steht vor einem herausfordernden Jahr 2009. Orad ist dabei stärker denn je aufgestellt und insofern überzeugt, die aktuelle weltweite Wirtschaftskrise erfolgreich zu meistern und als einer der Gewinner daraus hervorzugehen. “

Zusammenfassung wichtiger Kennzahlen für die vergangenen Jahre:



	<u>Q4/08</u>	<u>Q3/08</u>	<u>Q4/07</u>	<u>2008</u>	<u>2007</u>
<b>Sales</b>	8,012	8,153	6,875	31,888	22,940
<b>Gross Profits</b>	5,321	5,617	4,353	21,533	15,094
<b>Gross margin</b>	66.41%	68.89%	63.32%	67.53%	65.80%
<b>R&amp;D Expenses</b>	905	1,133	961	4,063	3,207
<b>S&amp;M Expenses</b>	2,534	2,747	2,195	10,444	8,474
<b>G&amp;A Expenses</b>	922	860	663	3,353	2,207
<b>Net Profit</b>	785	650	706	3,430	1,775
<b>Cash Status</b>	14,759	14,769	14,050	14,759	14,050

Das Unternehmen wird einen Conference Call für Journalisten und institutionelle Investoren am 23.02.2009, 12:00 Uhr deutscher Zeit, abhalten.

Der Jahresfinanzbericht wird von Ehud Ben-Yair, CEO Orad Hi-Tec Systems, präsentiert.

Um am Conference Call teilnehmen zu können, wenden Sie sich für die Zugangsdaten und die kostenfreie Einwahlnummer bitte an Dr. Rainer Brändle, edicto GmbH, Tel: 069-90550550, email [rbraendle@edicto.de](mailto:rbraendle@edicto.de).

Für weitere Informationen:

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

**CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2008**

**U.S. DOLLARS IN THOUSANDS**

**INDEX**

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

**CONSOLIDATED BALANCE SHEETS**

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

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 14,391	\$ 12,981
Restricted cash	368	1,069
Trade receivables (net of allowance for doubtful accounts of \$ 154 and \$ 117 at December 31, 2008 and 2007, respectively)	3,399	1,869
Other accounts receivable and prepaid expenses	1,748	1,163
Inventories	2,650	2,920
Work in progress, net of advances from customers	-	78
<u>Total current assets</u>	<u>22,556</u>	<u>20,080</u>
<b>SEVERANCE PAY FUND</b>	1,366	1,343
<b>PROPERTY AND EQUIPMENT, NET</b>	1,949	1,753
<u>Total assets</u>	<u>\$ 25,871</u>	<u>\$ 23,176</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$ 2,441	\$ 2,115
Deferred revenues	2,214	2,280
Other accounts payable and accrued expenses	4,503	5,718
<u>Total current liabilities</u>	9,158	10,113
<b>ACCRUED SEVERANCE PAY</b>	1,973	1,950
<u>Total liabilities</u>	11,131	12,063
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital:		
Ordinary shares of NIS 0.01 par value:		
Authorized - 27,000,000 shares as of December 31, 2008 and 2007;		
Issued - 11,749,304 and 10,820,550 shares as of December 31, 2008 and 2007, respectively; Outstanding - 10,820,550 shares as of December 31, 2008 and 2007;		
	29	29
Additional paid-in capital	75,672	75,475
Foreign currency translation adjustments	(547)	(547)
Accumulated deficit	(60,414)	(63,844)
<u>Total shareholders' equity</u>	14,740	11,113
<u>Total liabilities and shareholders' equity</u>	<u>\$ 25,871</u>	<u>\$ 23,176</u>

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

February 19, 2009

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 INCOME**

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

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Revenues	\$ 31,888	\$ 22,940	\$ 17,719
Cost of revenues	<u>10,355</u>	<u>7,846</u>	<u>6,901</u>
Gross profit	<u>21,533</u>	<u>15,094</u>	<u>10,818</u>
Operating expenses:			
Research and development, net	4,063	3,207	2,507
Sales and marketing	10,444	8,474	6,631
General and administrative	<u>3,353</u>	<u>2,207</u>	<u>1,506</u>
<u>Total operating expenses</u>	<u>17,860</u>	<u>13,888</u>	<u>10,644</u>
Operating income	3,673	1,206	174
Financial income (expenses), net	(257)	573	467
Other income (expenses), net	<u>14</u>	<u>(4)</u>	<u>(5)</u>
Net income	<u>\$ 3,430</u>	<u>\$ 1,775</u>	<u>\$ 636</u>
Basic net earnings per share	<u>\$ 0.32</u>	<u>\$ 0.16</u>	<u>\$ 0.06</u>
Weighted average number of shares used in computing basic net earnings per share (in thousands)	<u>10,821</u>	<u>10,821</u>	<u>10,791</u>
Diluted net earnings per share	<u>\$ 0.31</u>	<u>\$ 0.16</u>	<u>\$ 0.06</u>
Weighted average number of shares used in computing diluted net earnings per share (in thousands)	<u>11,022</u>	<u>10,982</u>	<u>10,823</u>

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

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

U.S. dollars in thousands, except share data

	Number of outstanding Ordinary shares	Share capital	Additional paid-in capital	Foreign currency translation adjustments	Accumulated deficit	Total comprehensive income	Total
Balance as of January 1, 2006	10,790,621	\$ 28	\$ 75,281	\$ (547)	\$ (66,255)		\$ 8,507
Net income	-	-	-	-	636	\$ 636	636
Issuance of shares upon exercise of employee share options	10,000	*) -	9	-	-	-	9
Stock-based compensation	-	-	67	-	-	-	67
Total comprehensive income						<u>\$ 636</u>	
Balance as of December 31, 2006	10,800,621	28	75,357	(547)	(65,619)		9,219
Net income	-	-	-	-	1,775	\$ 1,775	1,775
Issuance of shares upon exercise of employee share options	19,929	1	22	-	-	-	23
Stock-based compensation	-	-	96	-	-	-	96
Total comprehensive income						<u>\$ 1,775</u>	
Balance as of December 31, 2007	10,820,550	29	75,475	(547)	(63,844)		11,113
Net income	-	-	-	-	3,430	\$ 3,430	3,430
Stock-based compensation	-	-	197	-	-	-	197
Total comprehensive income						<u>\$ 3,430</u>	
Balance as of December 31, 2008	<u>10,820,550</u>	<u>\$ 29</u>	<u>\$ 75,672</u>	<u>\$ (547)</u>	<u>\$ (60,414)</u>		<u>\$ 14,740</u>

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

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

U.S. dollars in thousands

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
<u>Cash flows from operating activities:</u>			
Net income	\$ 3,430	\$ 1,775	\$ 636
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	740	545	569
Stock-based compensation	197	96	67
Decrease (increase) in trade receivables, net and other accounts receivable and prepaid expenses	(2,115)	227	1,214
Decrease (increase) in inventories	46	(384)	29
Decrease in work in progress, net of advances from customers	78	442	22
Increase (decrease) in trade payables, other accounts payable and accrued expenses and accrued severance pay, net	(889)	1,833	731
Increase (decrease) in deferred revenues	(66)	439	640
Other	-	-	5
Net cash provided by operating activities	<u>1,421</u>	<u>4,973</u>	<u>3,913</u>
<u>Cash flows from investing activities:</u>			
Purchase of property and equipment	(727)	(656)	(146)
Proceeds from sale of property and equipment	15	48	48
Decrease (increase) in restricted cash	701	(498)	(71)
Net cash used in investing activities	<u>(11)</u>	<u>(1,106)</u>	<u>(169)</u>
<u>Cash flows from financing activities:</u>			
Issuance of shares upon exercise of employee share options	-	23	9
Net cash provided by financing activities	<u>-</u>	<u>23</u>	<u>9</u>
Increase in cash and cash equivalents	1,410	3,890	3,753
Cash and cash equivalents at beginning of year	<u>12,981</u>	<u>9,091</u>	<u>5,338</u>
Cash and cash equivalents at end of year	<u>\$ 14,391</u>	<u>\$ 12,981</u>	<u>\$ 9,091</u>

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



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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U.S. dollars in thousands

**NOTE 1:- GENERAL**

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.

The Company's shares are listed for trading on the Frankfurt Stock Exchange under the symbol "OHT". Since 2003, the Company was also traded on the Alternative Investment Market ("AIM") of the London Stock Exchange but during 2008 it delisted its shares from trading on the AIM.

**NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES**

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

a. Use of estimates:

The preparation of the consolidated financial statements in conformity with U.S. 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 each of its subsidiaries operate. Thus, the functional and reporting currency of the Company and its subsidiaries is the U.S. dollar.

Accordingly, accounts maintained 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 of the remeasurement of monetary balance sheet items 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. Inter-company balances and transactions including profits from inter-company sales not yet realized have been eliminated upon consolidation.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

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

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.

Cost is determined as follows:

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

Products in process and finished products:

With respect to raw materials, parts and supplies - by the moving average method.

With respect to subcontracting costs - on the basis of actual expenses.

Inventory write-offs recorded in 2008, 2007 and 2006 amounted to \$ 624, \$ 440 and \$ 219, respectively.

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:

	%
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).

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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U.S. dollars in thousands

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

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. Assets to be disposed of are reported at the lower of the carrying amount or fair value less selling costs. As of December 31, 2008, 2007 and 2006, no impairment losses have been identified.

i. Revenue recognition:

The Company and its subsidiaries generate revenues mainly from sales of systems, contracts required significant customizations and from operating leases of equipment.

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.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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U.S. dollars in thousands

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

j. Warranty costs:

The Company offers a standard limited warranty for a period of one year for all of its products. The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs at the time revenues are recognized. Provision for warranty as of December 31, 2008, 2007 and 2006 amounted to \$ 494, \$ 286 and \$ 286, respectively. A tabular reconciliation of the changes in the Company's aggregate product warranty liability was not provided due to immateriality.

k. Research and development costs:

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

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 2008, 2007 and 2006, the Company received grants in the amount of \$ 0, \$ 141 and \$ 163, respectively.

m. 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 109"). This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances 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.

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 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained) otherwise a full liability in respect of a tax position not meeting the more-than-likely-than-not criteria is recognized. Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis that is more-likely-than-not to be realized upon ultimate settlement.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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U.S. dollars in thousands

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

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 2003 and 2006 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.

n. 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, severance pay deposits, hedging instruments 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. Severance pay deposits and hedging instruments are invested or held with major financial institutions 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 instruments.

Trade receivables are mainly derived from sales to customers located primarily in Europe, Asia, North America and South America. The Company and its subsidiaries performs ongoing credit evaluations of its customers and to date have not experienced any material losses. 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.

o. 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 and includes immaterial profits or losses.

Severance expenses for the years ended December 31, 2008, 2007 and 2006 amounted to approximately \$ 343, \$ 367 and \$ 313, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands**

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

- p. Basic and diluted net earnings per share:

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

- q. Fair value of financial instruments:

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

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

- r. Accounting for share-based compensation:

Effective January 1, 2006 ("the effective date"), the Company adopted SFAS No. 123(R), "Share-Based Payment" ("SFAS 123(R)") which is a revision of FASB Statement No. 123 "Accounting for Stock Based Compensation" ("SFAS") 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"), whereby compensation expenses are 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.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123(R), using the modified prospective transition method. Under that transition method, compensation cost recognized in the years ended December 31, 2007 and 2008, 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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**U.S. dollars in thousands**

provisions of SFAS 123(R). Results for prior periods have not been restated.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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U.S. dollars in thousands

**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.

The Company's additional disclosures required by SFAS 123(R) are provided in Note 10.

s. Impact of recently issued accounting standards:

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

In October 2008, the FASB issued FSP No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP 157-3"). FSP 157-3 clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 is effective upon issuance, including prior periods for which financial statements have not been issued. Revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate following the guidance in FASB Statement No. 154, "Accounting Changes and Error Corrections" ("SFAS 154"). However, the disclosure provisions in SFAS 154 for a change in accounting estimate are not required for revisions resulting from a change in valuation technique or its application. The adoption of FSP 157-3 did not have a material impact on the Company's financial position or results of operations.

In December 2007, the FASB issued SFAS 141(R), "Business Combinations" ("SFAS 141(R)). 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.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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U.S. dollars in thousands

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

SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS 141(R) is not expected to have a material effect on accounting for the current subsidiaries.

In December 2007, the FASB issued SFAS 160, "Noncontrolling Interests in Consolidated Financial Statements". ("SFAS 160") 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. The adoption of SFAS 160 is not expected to have a material on its financial position, results of operations or cash flows.

In March 2008, the FASB issued Statement 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"), an amendment to FASB No. 133. This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why and entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early application is encouraged. The Company does not expect the adoption of SFAS 161 to have a material impact on its financial position, results of operations or cash flows.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles". SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. It is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles". The adoption of this statement is not expected to have a material effect on the Company's financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands**

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

On October 29, 2008, the FASB issued FSP No.132 (R)-a, "Employers' Disclosures about Pensions and Other Postretirement Benefits", to require that an employer disclose the following information about the fair value of plan assets: 1) the level within the fair value hierarchy in which fair value measurements of plan assets fall; 2) information about the inputs and valuation techniques used to measure the fair value of plan assets; and 3) a reconciliation of beginning and ending balances for fair value measurements of plan assets using significant unobservable inputs. The FSP will be effective for fiscal years ending after December 15, 2009, with early application permitted. Application of the FSP would not be required for earlier periods that are presented for comparative purposes. The Company is currently evaluating the potential impact of adopting this FSP on its disclosures in the financial statements.

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

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Government authorities	\$ 836	\$ 283
Prepaid expenses	298	330
Deferred tax assets	382	300
Other	232	250
	<b>\$ 1,748</b>	<b>\$ 1,163</b>

**NOTE 4:- INVENTORIES**

Raw materials	\$ 762	\$ 583
Products in process and finished products	1,888	2,337
	<b>\$ 2,650</b>	<b>\$ 2,920</b>

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

Work in progress	\$ 1,986	\$ 1,986
Advances from customers	(1,308)	(1,308)
Provision for future estimated expenses or loss	(678)	(600)
	<b>\$ -</b>	<b>\$ 78</b>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands

**NOTE 6:- PROPERTY AND EQUIPMENT**

a. Comprised as follows:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Cost:		
Computers, software and peripheral equipment	\$ 8,981	\$ 8,201
Office furniture and equipment	391	362
Motor vehicles	89	70
Leasehold improvements	<u>2,425</u>	<u>2,361</u>
	<u>11,886</u>	<u>10,994</u>
Accumulated depreciation:		
Computers, software and peripheral equipment	7,661	7,301
Office furniture and equipment	360	234
Motor vehicles	57	63
Leasehold improvements	<u>1,859</u>	<u>1,643</u>
	<u>9,937</u>	<u>9,241</u>
Depreciated cost	<u>\$ 1,949</u>	<u>\$ 1,753</u>

b. Depreciation expense amounted to \$ 740, \$ 545 and \$ 569 for the years ended December 31, 2008, 2007 and 2006, respectively.

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

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Employees and payroll accruals	\$ 1,367	\$ 1,185
Accrued expenses	2,575	3,991
Government authorities	41	170
Warranty provision	494	286
Other	<u>26</u>	<u>86</u>
	<u>\$ 4,503</u>	<u>\$ 5,718</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands****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 including accrued interests at the LIBOR rate. 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 \$ 227, \$ 214 and \$ 276 for the years ended December 31, 2008, 2007 and 2006, respectively, relating to the accrual and repayment of such grants.

As of December 31, 2008 and 2007, the Company had a contingent obligation to pay royalties in the principal amount of \$ 1,857 and \$ 2,084, respectively.

## 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 linked to the dollar, plus interest on the unpaid amount based on the six month Libor rate applicable to dollar deposits.

During 2008, the Company had paid the total obligation to the Marketing Fund of the Government of Israel in a total amount of \$ 965.

## 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, 2008, are as follows:

2009	\$	555
2010		481
2011		391
2012		246
		<hr/>
	\$	<u>1,673</u>

Total rental expense for the years ended December 31, 2008, 2007 and 2006, amounted to \$ 557, \$ 556 and \$ 546, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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

c. Liens:

As of December 31, 2008, fixed pledges on cash deposits in the amount of \$ 272 were recorded on office lease agreements. The Company has also severed cash deposits in the amount of \$ 96 against guaranties to sever sales agreements.

d. Litigation:

Claims have been lodged against the Company in respect of various matters in the ordinary course of business and legal proceedings in respect thereof are under way. The Company's management is of the opinion, based upon the opinions of the legal advisors handling the claims, that the likelihood of the claims to prevail is remote.

**NOTE 9:- HEDGING INSTRUMENTS**

During 2008, the Company entered into put and call option contracts to hedge portions of its anticipated NIS payroll payments for the first and second quarters of 2009. These contracts are designated as cash flow hedges, as defined by Financial Accounting Standard Board Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities ("SFAS No. 133"), as amended, and are all considered by management as highly effective as hedges of these expenses.

As of December 31, 2008, the fair value of outstanding derivative instruments was immaterial.

**NOTE 10:- SHAREHOLDERS' EQUITY**

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. Stock option plan:

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****U.S. dollars in thousands, except share data****NOTE 10:- SHAREHOLDERS' EQUITY (Cont.)**

Options granted in 2008 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. Any options that are canceled or forfeited before expiration become available for future grants.

Total number of options available for future grants as of December 31, 2008 amounted to 115,273.

The Company estimates the fair value of stock options granted to employees on the date of the grant using the Black-Scholes-Merton option-pricing model. The option-pricing model requires a number of assumptions, noted in the following table, of which the most significant are expected stock price volatility and the expected option term. The computation of expected volatility is based on actual historical stock price movements.

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 110 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, 2008 and 2007 was estimated using the following weighted average assumptions:

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Risk free interest	1.91%	4.38%	4.89%
Dividend yields	0%	0%	0%
Volatility	69%	75%	66%
Expected term (in years)	4.25	4.25	4.25

During the years ended December 31, 2008, 2007 and 2006, the Company recognized stock-based compensation expenses related to employee stock options in the amount of \$ 197, \$ 96 and \$ 67, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share data

## NOTE 10:- SHAREHOLDERS' EQUITY (Cont.)

A summary of the Company's option activity as of December 31, 2008, and related information is as follows:

	Number of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value (in thousands)
Outstanding at beginning of year	883,876	\$ 5.34		
Granted	227,500	2.58		
Exercised	-			
Expired or forfeited	<u>(52,281)</u>	3.00		
Outstanding at end of year	<u>1,059,095</u>	<u>\$ 4.86</u>	<u>4.11</u>	<u>\$ 227</u>
Exercisable at end of year	<u>528,678</u>	<u>\$7.24</u>	<u>3.22</u>	<u>\$ 188</u>
Vested at the end of the year and expected to be vested	<u>1,059,095</u>	<u>\$4.86</u>	<u>4.11</u>	<u>\$ 227</u>

The weighted-average grant-date fair value of options granted during the years ended December 31, 2008, 2007 and 2006 was \$ 1.41, \$ 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 2008 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2008. This amount changes, based on the fair market value of the Company's stock.

As of December 31, 2008, there was approximately \$ 685 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 3.11 years. Total grant-date fair value of options vested as of December 31, 2008 was \$ 172.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

U.S. dollars in thousands, except share data

**NOTE 10:- SHAREHOLDERS' EQUITY (Cont.)**

The following table summarizes information about options outstanding and exercisable as of December 31, 2008:

Range of exercise price	Options outstanding as of December 31, 2008	Weighted average remaining contractual life (years)	Weighted average exercise price	Options exercisable as of December 31, 2008	Weighted average exercise price of options exercisable
\$0.80 - 1.19	114,321	4.80	\$ 1.00	108,071	\$ 0.99
\$1.28 - 1.90	290,000	3.28	\$ 1.77	180,833	\$ 1.75
\$2.14 - 3.06	528,214	5.14	\$ 2.67	116,964	\$ 2.62
\$ 4.6	5,000	4.36	\$ 4.60	1,250	\$ 4.60
\$9.08 - 11.71	18,842	0.44	\$11.71	18,842	\$ 11.71
\$20.71	49,218	0.92	\$20.71	49,218	\$ 20.71
\$33.18 - 34.95	<u>53,500</u>	1.13	\$34.60	<u>53,500</u>	\$ 34.60
	<u>1,059,095</u>	4.11	<u>\$ 4.86</u>	<u>528,678</u>	<u>\$ 7.24</u>

All of the options granted to employees, officers and directors in 2008 and 2007 have an exercise price equal to the fair market value of the share at date of grant.

## c. 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.

**NOTE 11:- INCOME TAXES**

- a. In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FAS 109. This interpretation prescribes a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition of tax positions, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 requires significant judgment in determining what constitutes an individual tax position as well as assessing the outcome of each tax position. Changes in judgment as to recognition or measurement of tax positions can materially affect the estimate of the effective tax rate and consequently, affect the operating results of the Company.

The Company adopted the provision of FIN 48 as of January 1, 2007. As a result of the implementation of FIN 48, 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.



## NOTE 11:- INCOME TAXES (Cont.)

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.

According to the law, until 2007, the results for tax purposes were measured based on 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. Starting 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. The amendment to the law includes, inter alia, the elimination of the inflationary additions and deductions and the additional deduction for depreciation starting 2008.

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 Israeli 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.

#### **NOTE 11:- INCOME TAXES (Cont.)**

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.

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, 2008, accumulated deficit include some tax exempt profits earned historically 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".

On April 1, 2005, an amendment to the Law came into effect ("the Amendment") and has significantly changed the provisions of the Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as a "Beneficiary Enterprise" (rather than the previous terminology of Approved Enterprise), such as a provision requiring that at least 25% of the "Beneficiary Enterprise's" income will be derived from export.

Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Law so that companies are no longer required for Investment Center approval in order to qualify for tax benefits. The period of tax benefits for a new "Beneficiary Enterprise" commences in the "Year of Commencement". This year is the later of: (1) the year in which taxable income is first generated by the company, or (2) a year selected by the company for commencement, on the condition that the company meets certain provisions provided by the Law ("Year of Election").

However, the Law provides that terms and benefits included in any letter of approval already granted will remain subject to the provisions of the Law as they were on the date of such approval. Therefore, the Company's existing "Approved Enterprises" programs will generally not be subject to the provisions of the Amendment. As a result of the Amendment, tax-exempt income generated under the provisions of the new law, will subject the Company to taxes upon distribution or liquidation and the Company may be required in the future to record deferred tax liability with respect to such tax-exempt income. As of December 31, 2008, the Company did not generate income under the provisions of the new law.

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the above law, regulations published there under and the instruments of approval for the specific investments in "Approved Enterprises" or "Beneficiary Enterprise". In the event of failure to comply with these conditions, in whole or in part, the Company may be required to pay additional taxes for the period in which it benefited from the tax exemption and would likely be denied these benefits in the future.

In the event of a dividend distribution (including withdrawals and charges that are deemed to be dividends) out of the income originating from the approved enterprise, income from such distributed dividend will be subject to the corporate tax rate applicable to such profits as if the Company had not elected the alternative system of benefits.

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

**NOTE 11:- INCOME TAXES (Cont.)**

In December, 2008, the Company applied to the Israeli tax authorities for approval of a new "Beneficiary Enterprise" status and requested the year 2008 to be the Year of Election.

b. Tax assessments:

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

c. Net operating carryforward losses:

The Company has accumulated losses for tax purposes as of December 31, 2008, in the amount of approximately \$ 10,500 which may be carried forward and offset against taxable income in the future for an indefinite period.

The carryforward losses of the Israeli subsidiary, amounting to approximately \$ 1,050.

Foreign:

The carryforward losses of the French subsidiary, amounting to approximately \$ 15,000 which may be carried forward and offset against taxable income in the future, for an indefinite period.

The carryforward losses of the U.S. subsidiary, amounting to approximately \$ 11,500 as of December 31, 2008, can be utilized mainly from 2018 to 2029. 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 carryforward losses of the other subsidiaries amount to approximately \$ 5,850 as of December 31, 2008. The majority of these carryforward losses can be utilized indefinitely.

e. Deferred income taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company and its subsidiaries deferred tax liabilities and assets are as follows:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Carryforwards tax loss	\$ 13,005	\$ 15,241
Valuation allowance	<u>(12,623)</u>	<u>(14,941)</u>
Net deferred tax asset	<u>\$ 382</u>	<u>\$ 300</u>

Management currently believes that it is more likely than not that the deferred tax regarding the carry forwards loss for which valuation allowance was provided will not be realized in the foreseeable future.

**NOTE 11:- INCOME TAXES (Cont.)**

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

In 2008, 2007 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.

**NOTE 12:- 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>2008</b>	<b>2007</b>	<b>2006</b>
Europe	\$ 15,464	\$ 12,913	\$ 9,930
Asia	5,784	3,465	3,969
Americas	8,749	5,496	3,321
Other	1,891	1,066	499
	<u>\$ 31,888</u>	<u>\$ 22,940</u>	<u>\$ 17,719</u>

b. Long-lived assets by geographic region:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
Israel	\$ 1,677	\$ 1,421
Europe	154	208
Americas	65	85
Other	53	39
	<u>\$ 1,949</u>	<u>\$ 1,753</u>

**NOTE 13:- FINANCIAL INCOME (EXPENSES), NET**

	<b>Year ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Financial income:			
Foreign currency translation adjustments, net	\$ -	\$ 295	\$ 244
Interest on bank deposits, net	158	402	301
	<u>158</u>	<u>697</u>	<u>545</u>
Financial expenses:			
Foreign currency transaction adjustments, net	(326)	-	-
Bank charges	(89)	(124)	(78)
	<u>(415)</u>	<u>(124)</u>	<u>(78)</u>
	<u>\$ (257)</u>	<u>\$ 573</u>	<u>\$ 467</u>

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