



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

Ergebnisse für das Geschäftsjahr 2009 und das vierte Quartal 2009

Tel Aviv, 1. März 2010. – Die Orad Hi-Tec Systems Ltd. (ISIN IL0010838071; Symbol: OHT), ein führender Entwickler und Anbieter von in Echtzeit arbeitenden TV-Produktions- und virtuellen Grafiklösungen, hat heute die Ergebnisse für das Geschäftsjahr 2009 und das vierte Quartal 2009 bekannt gegeben.

- **Umsatzanstieg im 4. Quartal 2009 um 12% auf 9 Mio. US-Dollar, verglichen mit 8 Mio. US-Dollar im Vorjahresquartal.**
- **Überschuss legt im 4. Quartal 2009 um 44% auf 1,1 Mio. US-Dollar zu, gegenüber 0,8 Mio. US-Dollar im 4. Quartal 2008**
- **Liquide Mittel steigen auf 17,3 Mio. US-Dollar. Der Cashflow belief sich im 4. Quartal 2009 auf 1,2 Mio. US-Dollar und im gesamten Jahr 2009 auf 2,5 Mio. US-Dollar.**
- **In 2009 führte Orad das neue Produkt „Morpho“ ein und konnte davon bereits nahezu 100 Stück verkaufen**
- **Seit dem 4. Quartal 2009 adressiert Orad mit dem „Playmaker“, einem Zeitlupen-Server, ein neues Produkt-Segment auf dem TV-Markt, das weitaus größer ist als der Markt für grafische Lösungen. Die Lösung konnte bereits in mehreren Ländern verkauft werden.**

Avi Sharir, CEO und Präsident von Orad, kommentiert: „2009 war ein Jahr der Herausforderungen. Die weltweite Finanzkrise traf die gesamte Industrie und damit auch Orad. Dennoch konnten wir die Krise im Vergleich zu den Wettbewerbern relativ gut durchstehen. Wir sind über die Ergebnisse ebenso erfreut wie über die Tatsache, dass wir unsere Profitabilität und unseren positiven Cashflow aufrecht erhalten

konnten. In 2009 setzten wir unseren Kurs fort, neue Produkte zu entwickeln und zu verkaufen, die es uns ermöglichen werden, das Wachstum unseres Unternehmens in den kommenden Jahren zu sichern. Das Produkt „Morpho“ läuft gut und der Markt für Zeitlupen-Server ist beträchtlich.

Seit Ende 2008“, fügt er hinzu, „beobachteten wir eine zunehmende Nachfrage nach unseren kosten sparenden Lösungen für den high-end-Markt. Orads Virtuelle-Studio-Lösung, hierin sind wir Weltmarktführer, ist das beste Beispiel für unsere kosten sparenden Lösungen. Der Anstieg der Verkaufszahlen bei den Virtuellen Studios half uns auch in der Wirtschaftskrise.

In 2009 vollendeten wir ebenfalls das Globale Netzwerk Projekt – eine einzigartige Lösung für HD Virtuelle Studios für Netzwerke. Orad gewann den IBC (International Broadcasting Conference) Innovationspreis in der Kategorie Redaktionssysteme für seine Beteiligung am Projekt des belgischen Senders RTBF.

Orad wird seine Produkte kontinuierlich verbessern, um die Effizienz und die reibungslose Integration in die Arbeitsprozesse der Kunden weiter zu steigern.

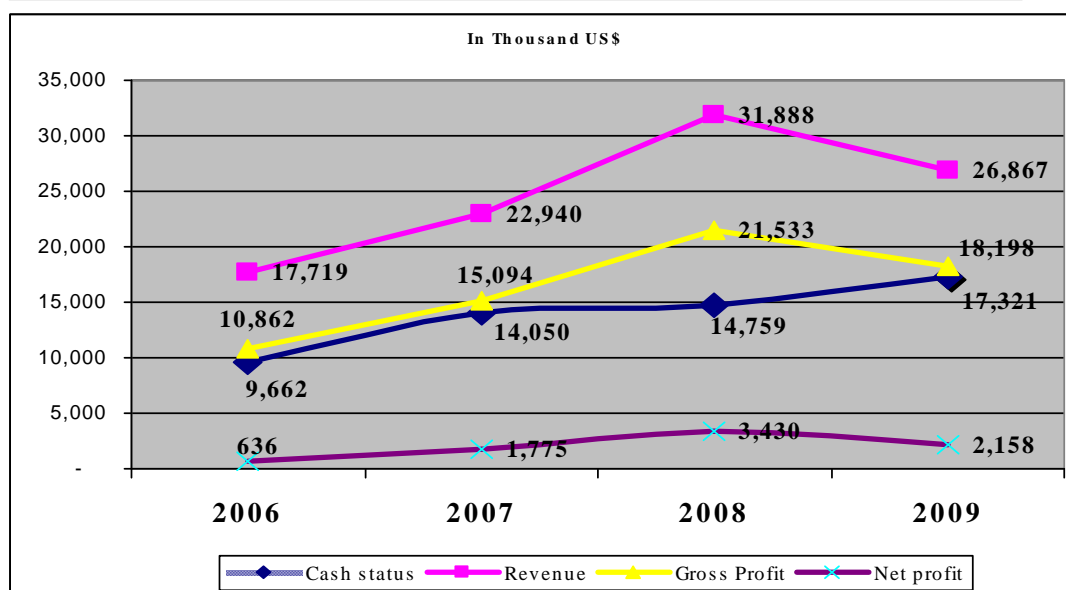
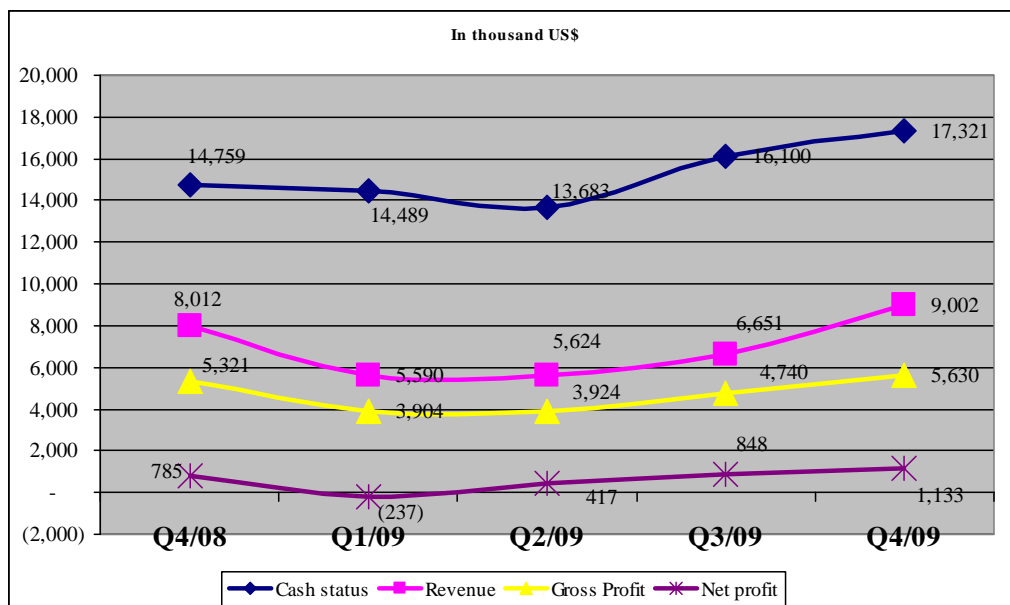
Das 4. Quartal ist traditionell besonders stark. Der gestiegene Auftragsbestand gibt uns die Zuversicht, dass das kommende Jahr für uns erfolgreich sein wird.

Es ist wichtig zu betonen, dass Orads Zuwachs an liquiden Mitteln einzig auf das operative Geschäft zurückzuführen ist. Wir halten weiterhin Ausschau nach attraktiven Unternehmen, die Lösungen im Umfeld der Sender anbieten und für eine Übernahme in Frage kommen.“

Die Zahlen für das 4. Quartal 2009 und für das Gesamtjahr 2009:

- **Umsatzanstieg im 4. Quartal 2009 um 35 % gegenüber dem 3. Quartal 2009 von 6,7 Mio. US-Dollar auf 9 Mio. US-Dollar; Umsatzanstieg um 12 % gegenüber dem Vorjahreszeitraum, der 8 Mio. US-Dollar verzeichnete.**
- **Umsatz im Gesamtjahr 2009 mit 26,9 Mio. US-Dollar um 16 % unter dem Vorjahreswert von 31,9 Mio. US-Dollar.**
- **Rohertragsmarge blieb 2009 stabil bei 67%.**
- **Der Überschuss legte im 4. Quartal 2009 um 33% auf 1,1 Mio. US-Dollar zu, verglichen mit 0,8 Mio. US-Dollar im vorangegangenen Quartal. Gegenüber dem Vorjahresquartal stieg der Überschuss um 44%.**
- **Der Jahresüberschuss 2009 betrug 2,2 Mio. US-Dollar, was einem Rückgang um 37% gegenüber dem Vorjahreswert von 3,4 Mio. US-Dollar entspricht.**
- **Die liquiden Mittel stiegen auf 17,3 Mio. US-Dollar. Der Cashflow belief sich auf 2,5 Mio. US-Dollar 2009, davon 1,2 Mio. US-Dollar im 4. Quartal. Der starke Cashflow resultiert vor allem aus dem gestiegenen Auftragsbestand im 4. Quartal 2009.**

Zusammenfassung der Kennzahlen für die entsprechenden Zeiträume



| | <u>Q4/08</u> | <u>Q4/09</u> | <u>Q3/09</u> | <u>2008</u> | <u>2009</u> |
|--------------------------------------|--------------|--------------|--------------|-------------|-------------|
| Tausend US-Dollar | | | | | |
| Umsatz | 8.012 | 9.002 | 6.651 | 31.888 | 26.867 |
| Roherttrag | 5.321 | 5.630 | 4.740 | 21.533 | 18.198 |
| Roherttragsmarge | 66,41% | 62,54% | 71,27% | 67,53% | 67,73% |
| Forschung und Entwicklung | 905 | 964 | 952 | 4.063 | 3.633 |

| | | | | | |
|--------------------------------|--------|--------|--------|--------|--------|
| Sales und Marketing | 2.534 | 2.509 | 2.418 | 10.444 | 9.467 |
| Verwaltung und Vertrieb | 922 | 791 | 694 | 3.353 | 2.711 |
| Überschuss | 785 | 1.133 | 849 | 3.430 | 2.158 |
| Liquide Mittel | 14.759 | 17.321 | 16.100 | 14.759 | 17.321 |

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ORAD HI-TEC SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2009

U.S. DOLLARS IN THOUSANDS

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REPORT OF INDEPENDENT AUDITORS**To the Shareholders and Board of Directors 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, 2009 and 2008, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2009. These consolidated 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 a certain wholly-owned subsidiary, whose assets constitute XX% and 4% of total consolidated assets as of December 31, 2009 and 2008, respectively and whose revenues constitute XX%, 10% and 4% of total consolidated revenues for the years ended December 31, 2009, 2008 and 2007, respectively. Those statements were audited by other auditors whose report have been furnished to us, and our opinion, insofar as it relates to amounts included for that company, is based solely on the report 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 report of other auditors provide a reasonable basis for our opinion.

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

Tel-Aviv, Israel
February 28, 2010KOST 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

| | December 31, | |
|---|---------------------|------------------|
| | 2009 | 2008 |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 16,949 | \$ 14,391 |
| Restricted cash | 372 | 368 |
| Trade receivables (net of allowance for doubtful accounts of \$ 184 and \$ 154 at December 31, 2009 and 2008, respectively) | 3,155 | 3,399 |
| Other accounts receivable and prepaid expenses | 1,306 | 1,748 |
| Inventories | 1,912 | 2,650 |
| <u>Total current assets</u> | <u>23,694</u> | <u>22,556</u> |
| SEVERANCE PAY FUND | 1,836 | 1,366 |
| PROPERTY AND EQUIPMENT, NET | 1,442 | 1,949 |
| <u>Total assets</u> | <u>\$ 26,972</u> | <u>\$ 25,871</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade payables | \$ 1,532 | \$ 2,441 |
| Deferred revenues | 1,454 | 2,214 |
| Other accounts payable and accrued expenses | 4,463 | 4,503 |
| <u>Total current liabilities</u> | <u>7,449</u> | <u>9,158</u> |
| ACCRUED SEVERANCE PAY | 2,380 | 1,973 |
| <u>Total liabilities</u> | <u>9,829</u> | <u>11,131</u> |
| SHAREHOLDERS' EQUITY: | | |
| Share capital - | | |
| Ordinary shares of NIS 0.01 par value - | | |
| Authorized: 27,000,000 shares as of December 31, 2009 and 2008; | | |
| Issued: 11,749,304 shares as of December 31, 2009 and 2008; | | |
| Outstanding: 10,820,550 shares as of December 31, 2009 and 2008 | 29 | 29 |
| Additional paid-in capital | 75,917 | 75,672 |
| Foreign currency translation adjustments | (547) | (547) |
| Accumulated deficit | (58,256) | (60,414) |
| <u>Total shareholders' equity</u> | <u>17,143</u> | <u>14,740</u> |
| <u>Total liabilities and shareholders' equity</u> | <u>\$ 26,972</u> | <u>\$ 25,871</u> |

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

February 28, 2010

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

| | Year ended December 31, | | |
|---|--------------------------------|-------------|-------------|
| | 2009 | 2008 | 2007 |
| Revenues | \$ 26,867 | \$ 31,888 | \$ 22,940 |
| Cost of revenues | 8,669 | 10,355 | 7,846 |
| Gross profit | 18,198 | 21,533 | 15,094 |
| Operating expenses: | | | |
| Research and development, net | 3,633 | 4,063 | 3,207 |
| Sales and marketing | 9,467 | 10,444 | 8,474 |
| General and administrative | 2,711 | 3,353 | 2,207 |
| <u>Total operating expenses</u> | 15,811 | 17,860 | 13,888 |
| Operating income | 2,387 | 3,673 | 1,206 |
| Financial income (expenses), net | (223) | (257) | 573 |
| Other income (expenses), net | (6) | 14 | (4) |
| Net income | \$ 2,158 | \$ 3,430 | \$ 1,775 |
| Basic net earnings per share | \$ 0.1 | \$ 0.32 | \$ 0.16 |
| Weighted average number of shares used in computing basic net earnings per share (in thousands) | 10,821 | 10,821 | 10,821 |
| Diluted net earnings per share | \$ 0.2 | \$ 0.31 | \$ 0.16 |
| Weighted average number of shares used in computing diluted net earnings per share (in thousands) | 10,943 | 11,022 | 10,982 |

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, 2007 | 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 | 10,820,550 | 29 | 75,672 | (547) | (60,414) | | 14,740 |
| Net income | - | - | - | - | 2,158 | \$ 2,158 | 2,158 |
| Stock-based compensation | - | - | 245 | - | - | - | 245 |
| Total comprehensive income | | | | | | <u>\$ 2,158</u> | |
| Balance as of December 31, 2009 | <u>10,820,550</u> | <u>\$ 29</u> | <u>\$ 75,917</u> | <u>\$ (547)</u> | <u>\$ (58,256)</u> | | <u>\$ 17,143</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

| | Year ended December 31, | | |
|---|--------------------------------|------------------|------------------|
| | 2009 | 2008 | 2007 |
| <u>Cash flows from operating activities:</u> | | | |
| Net income | \$ 2,158 | \$ 3,430 | \$ 1,775 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 780 | 740 | 545 |
| Stock-based compensation | 245 | 197 | 96 |
| Decrease (increase) in trade receivables, net and other accounts receivable and prepaid expenses | 686 | (2,115) | 227 |
| Decrease (increase) in inventories | 639 | 46 | (384) |
| Decrease in work in progress, net of advances from customers | - | 78 | 442 |
| Increase (decrease) in trade payables, other accounts payable and accrued expenses and accrued severance pay, net | (1,012) | (889) | 1,833 |
| Increase (decrease) in deferred revenues | (760) | (66) | 439 |
| Net cash provided by operating activities | <u>2,736</u> | <u>1,421</u> | <u>4,973</u> |
| <u>Cash flows from investing activities:</u> | | | |
| Purchase of property and equipment | (178) | (727) | (656) |
| Proceeds from sale of property and equipment | 4 | 15 | 48 |
| Decrease (increase) in restricted cash | (4) | 701 | (498) |
| Net cash used in investing activities | <u>(178)</u> | <u>(11)</u> | <u>(1,106)</u> |
| <u>Cash flows from financing activities:</u> | | | |
| Issuance of shares upon exercise of employee share options | - | - | 23 |
| Net cash provided by financing activities | <u>-</u> | <u>-</u> | <u>23</u> |
| Increase in cash and cash equivalents | 2,558 | 1,410 | 3,890 |
| Cash and cash equivalents at beginning of year | <u>14,391</u> | <u>12,981</u> | <u>9,091</u> |
| Cash and cash equivalents at end of year | <u>\$ 16,949</u> | <u>\$ 14,391</u> | <u>\$ 12,981</u> |
| <u>Supplemental disclosure of cash flows activities:</u> | | | |
| Classification between property and equipment and inventories - net | <u>99</u> | <u>224</u> | <u>160</u> |

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

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 Accounting Codification Statement ("ASC") 830, "Foreign Currency Matters" (formerly: Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation"). 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.

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, excess inventories, discontinued products, new products introduction and for market prices lower than cost. Any write-off is recognized in the consolidated statement of operations as cost of revenue.

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 2009, 2008 and 2007 amounted to \$ 269, \$ 624 and \$ 440, 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:

| | <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).

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 ASC 360, "Property, Plant and Equipment" (formerly: SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"), whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the 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 of fair value less selling costs. As of December 31, 2009, 2008 and 2007, 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 ASC 985, "Software (formerly: SFAS No. 97-2, "Software Revenue Recognition"), 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 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 ASC 605-35, "Construction - Type and Productions - Type Contracts" (formerly: SOP No. 81-1, "Accounting for Performance of Construction Type and Certain Production Type Contracts"), using contract accounting on the completed-contract method. 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 ASC 840, "Leases" (formerly: SFAS No. 13, "Accounting for Leases").

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 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, 2009, 2008 and 2007 amounted to \$ 350, \$ 494 and \$ 286, respectively. A tabular reconciliation of the changes in the Company's aggregate product warranty liability was not provided due to immateriality.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

k. Research and development costs:

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

l. Grants:

Royalty-bearing grants from the Government of Israel and non-royalty-bearing grants from the European Union, for funding approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the costs incurred.

Non-royalty-bearing grants are presented as a deduction from research and development expenses. During the years 2009, 2008 and 2007, the Company received grants in the amount of \$ 0, \$ 0 and \$ 141, respectively.

Royalty-bearing grants are presented as a reduction in research and development expenses when there is reasonable assurance that the grants will not be repaid based on estimated future sales. Such grants are recorded as a liability when repayment is probable.

m. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with ASC 740, "Income Taxes" ("ASC 740") (formerly: SFAS No. 109 "Accounting for Income Taxes"). ASC 740 prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between the financial reporting and the tax basis 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 Group provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value, if it is more likely than not that a portion or all of the deferred tax assets will not be realized.

In July 2006, the FASB issued ASC 740-10, "Income Taxes" ("ASC 740-10") (formerly: FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" ("FIN 48")). ASC 740-10 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. ASC 740-10 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.

ASC 740-10 applies to all tax positions related to income taxes subject to ASC 740. This includes tax positions considered to be "routine" as well as those with a high degree of uncertainty. FIN 48 has expanded disclosure requirements, which include a tabular roll forward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months.

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 Company has submitted its tax return for the years 2004-2008, which are still pending for 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 ASC 740. In addition, the Company did not record a cumulative effect adjustment related to the adoption of ASC 740.

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 Luxemburg, Singapore and in Israel. Severance pay deposits and hedging instruments are invested or held with major financial institutions in Israel. Generally, these cash and cash equivalents may be redeemed upon demand and, therefore management believes that they bear lower risk.

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 Israel's 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, 2009, 2008 and 2007 amounted to approximately \$ 231, \$ 343 and \$ 367, respectively.

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 ASC 260, "Earnings Per Share" (formerly: SFAS No. 128, "Earnings per Share").

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

q. Derivatives and hedging activities:

ASC 815, "Derivatives and Hedging" ("ASC 815") (formerly: SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"), as amended, requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

r. 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.

s. Accounting for share-based compensation:

Effective January 1, 2006 ("the effective date"), the Company adopted ASC 718, "Compensation Stock-Compensation" (formerly SFAS No. 123(R), "Share-Based Payment") 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. ASC 718 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 ASC 718. The Company has applied the provisions of SAB 107 in its adoption of ASC 718.

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 ASC 718, 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 ASC 718, using the modified prospective transition method. Under that transition method, compensation cost recognized in the years ended December 31, 2008 and 2009, 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 ASC 718. Results for prior periods have not been restated.

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 ASC 718 are provided in Note 10.

t. Impact of recently issued accounting standards:

In May 2009, the FASB issued ASC 855, "Subsequent Events", ("ASC 855") (originally issued as SFAS 165). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855 is effective for interim and annual reporting periods ending after June 15, 2009. The Company evaluated all events or transactions that occurred after December 31, 2009 up through February 28, 2010. During this period no material subsequent events came to its attention.

In June 2009, the FASB issued SFAS 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 168"), which is incorporated in ASC 105, "Generally Accepted Accounting Principles", identifies the accounting standard codification as the authoritative source of generally accepted accounting principles in the United States.

In August 2009, the FASB issued ASU No. 2009-05 "Fair Value Measurements and Disclosures (Topic 820) - Measuring Liabilities at Fair Value" ("ASU 2009-05"). ASU 2009-05 amends Subtopic 820-10 "Fair Value Measurements and Disclosures - Overall" and provides clarification on the methods to be used in circumstances in which a quoted price in an active market for the identical liability is not available. The provisions of ASU 2009-05 are effective for the third quarter of our fiscal 2009. The adoption of ASU 2009-05 did not have a material impact on our financial statements.

In September 2009, the FASB reached a consensus on Accounting Standards Update, or ASU, 2009-13, "Revenue Recognition" (Topic 605) - "Multiple-Deliverable Revenue Arrangements", or ASU 2009-13 and ASU 2009-14, "Software" (Topic 985) - "Certain Revenue Arrangements That Include Software Elements", or ASU 2009-14. ASU 2009-13 modifies the requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered. ASU 2009-13 eliminates the requirement that all undelivered elements must have either: i) VSOE or ii) third-party evidence (TPE), before an entity can recognize the portion of an overall arrangement consideration that is attributable to items that already have been delivered. In the absence of VSOE or TPE of the standalone selling price for one or more delivered or undelivered elements in a multiple-element arrangement, entities will be required to estimate the selling prices of those elements. Overall arrangement consideration will be allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on the entity's estimated selling price. The residual method of allocating arrangement consideration has been eliminated. ASU 2009-14 modifies the software revenue recognition guidance to exclude from its scope tangible products that contain both software and non-software components that function together to deliver a product's essential functionality. These new updates are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of these ASUs will have on its consolidated financial statements.

NOTE 3: - OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

| | December 31, | |
|------------------------|---------------------|-----------------|
| | 2009 | 2008 |
| Government authorities | \$ 262 | \$ 836 |
| Prepaid expenses | 299 | 298 |
| Deferred tax assets | 428 | 382 |
| Other | 317 | 232 |
| | <u>\$ 1,306</u> | <u>\$ 1,748</u> |

NOTE 4:- INVENTORIES

| | | |
|---|-----------------|-----------------|
| Raw materials | \$ 771 | \$ 762 |
| Products in process and finished products | <u>1,141</u> | <u>1,888</u> |
| | <u>\$ 1,912</u> | <u>\$ 2,650</u> |

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

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

NOTE 6:- PROPERTY AND EQUIPMENT

a. Comprised as follows:

Cost:

| | | |
|--|--------------|--------------|
| Computers, software and peripheral equipment | \$ 3,290 | \$ 8,981 |
| Office furniture and equipment | 440 | 391 |
| Motor vehicles | 59 | 89 |
| Leasehold improvements | <u>2,211</u> | <u>2,425</u> |

6,000 11,886

Accumulated depreciation:

| | | |
|--|--------------|--------------|
| Computers, software and peripheral equipment | 2,568 | 7,661 |
| Office furniture and equipment | 296 | 360 |
| Motor vehicles | 26 | 57 |
| Leasehold improvements | <u>1,668</u> | <u>1,859</u> |

4,558 9,937

Depreciated cost

\$ 1,442 \$ 1,949

b. Depreciation expense amounted to \$ 780, \$ 740 and \$ 545 for the years ended December 31, 2009, 2008 and 2007, respectively.

NOTE 7:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

| | December 31, | |
|--------------------------------|---------------------|-----------------|
| | 2009 | 2008 |
| Employees and payroll accruals | \$ 335 | \$ 1,367 |
| Accrued expenses | 3,725 | 2,575 |
| Government authorities | 43 | 41 |
| Warranty provision | 350 | 494 |
| Other | 10 | 26 |
| | <u>\$ 4,463</u> | <u>\$ 4,503</u> |

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 inters 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 \$ 277, \$ 227 and \$ 214 for the years ended December 31, 2009, 2008 and 2007, respectively, relating to the accrual and repayment of such grants.

As of December 31, 2009 and 2008, the Company had a contingent obligation to pay royalties in the principal amount of \$ 1,579 and \$ 1,857, 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 the amount of \$ 965.

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

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, 2009, are as follows:

| | | |
|------|----|-------|
| 2010 | \$ | 684 |
| 2011 | | 549 |
| 2012 | | 349 |
| 2013 | | 148 |
| | | <hr/> |
| | \$ | 1,730 |
| | | <hr/> |

Total rental expense for the years ended December 31, 2009, 2008 and 2007, amounted to \$ 634, \$ 557 and \$ 556, respectively.

c. Liens:

As of December 31, 2009, fixed pledges on cash deposits in the amount of \$ 272 were recorded on office lease agreements. The Company has also several cash deposits in the amount of \$ 100 against guaranties to several 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 attorney, handling the claims, that the likelihood of the claims to prevail is remote.

NOTE 9:- HEDGING INSTRUMENTS

To protect against changes in value of forecasted foreign currency cash flows resulting from salaries and other assets that are denominated in NIS, the Company has entered into foreign currency forward contracts and put option contracts. These contracts are designated as cash flows hedges, as defined by ASC 815 (formerly SFAS No. 133), as amended, and are considered highly effective as hedges of these expenses.

During the years ended December 31, 2009 and 2008, the Company recognized a net income of \$ 16 and net expenses \$ 77, respectively, related to the effective portion of its hedging instruments. The effective portion of the hedged instruments has been included as an offset of payroll expenses and financial expenses in the statement of operations.

The fair value of the hedging instruments as of December 31, 2009 and 2008 constituted an asset of approximately \$ 53 and \$ 0 respectively. The term of all of these instruments as of December 31, 2009 are less than one year.

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, 900,000 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 allotted under the 1996 Share Option Plan as being reserved for allotment under the 2003 Share Option Plan. During 2008, an additional 253,500 options to purchase Ordinary shares have been reserved for issuance.

Options granted 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, 2009 amounted to 194,614.

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, 2009 and 2008 was estimated using the following weighted average assumptions:

| | Year ended December 31, | | |
|--------------------------|-------------------------|-------|-------|
| | 2009 | 2008 | 2007 |
| Risk free interest | - | 1.91% | 4.38% |
| Dividend yields | - | 0% | 0% |
| Volatility | - | 69% | 75% |
| Expected term (in years) | - | 4.25 | 4.25 |

During the years ended December 31, 2009, 2008 and 2007, the Company recognized stock-based compensation expenses related to employee stock options in the amount of \$ 245, \$ 197 and \$ 96, respectively.

NOTE 10:- SHAREHOLDERS' EQUITY (Cont.)

A summary of the Company's option activity as of December 31, 2009, and related information is as follows:

| | <u>Number of options</u> | <u>Weighted average exercise price</u> | <u>Weighted average remaining contractual term (in years)</u> | <u>Aggregate intrinsic value (in thousands)</u> |
|---|------------------------------|--|---|---|
| Outstanding at beginning of year | 1,059,095 | \$4.86 | | |
| Granted | - | | | |
| Exercised | - | | | |
| Expired or forfeited | <u>(73,060)</u> | | | |
| Outstanding at end of year | <u>986,035</u> | <u>\$ 3.95</u> | <u>3.33</u> | <u>\$ 945</u> |
| Exercisable at end of year | <u>682,285</u> | <u>\$4.55</u> | <u>2.30</u> | <u>\$ 732</u> |
| Vested at the end of the year and expected to be vested | <u>986,035</u> | <u>\$3.95</u> | <u>3.33</u> | <u>\$ 945</u> |

The weighted-average grant-date fair value of options granted during the years ended December 31, 2009, 2008 and 2007 was \$ 0, \$ 1.41 and \$ 1.73, 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 2009 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, 2009. This amount changes, based on the fair market value of the Company's stock.

As of December 31, 2009, there was approximately \$ 442 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 2.28 years. Total grant-date fair value of options vested as of December 31, 2009 was \$ 250.

The following table summarizes information about options outstanding and exercisable as of December 31, 2009:

| <u>Range of exercise price</u> | <u>Options outstanding as of December 31, 2009</u> | <u>Weighted average remaining contractual life (years)</u> | <u>Weighted average exercise price</u> | <u>Options exercisable as of December 31, 2009</u> | <u>Weighted average exercise price of options exercisable</u> |
|--|--|--|--|--|---|
| \$0.80 - 1.19 | 114,321 | 3.80 | \$ 1.00 | 114,321 | \$ 1.00 |
| \$1.28 - 1.90 | 290,000 | 2.28 | \$ 1.77 | 243,750 | \$ 1.74 |
| \$2.14 - 3.06 | 523,214 | 4.13 | \$ 2.67 | 268,214 | \$ 2.61 |
| \$4.60 | 5,000 | 3.36 | \$ 4.60 | 2,500 | \$ 4.60 |
| \$33.18 - 34.95 | <u>53,500</u> | 0.13 | \$34.60 | <u>53,500</u> | \$ 34.60 |
| | <u>986,035</u> | | <u>\$ 3.95</u> | <u>682,285</u> | <u>\$ 4.55</u> |

All of the options granted to employees, officers and directors in 2009 and 2008 have an exercise price equal to the fair market value of the share at date of grant.

NOTE 10:- SHAREHOLDERS' EQUITY (Cont.)

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. ASC 740-10, "Income Taxes" ("ASC 740-10") (formerly: FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" ("FIN 48")) clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. This standard prescribes a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. ASC 740 also provides guidance on derecognition of tax positions, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure and transition. ASC 740 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.

As a result of the implementation of ASC 740, 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 ASC 740. In addition, the Company did not record a cumulative effect adjustment related to the adoption of ASC 740.

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 ASC 740-10-25-3, 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 (Israel's 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.

NOTE 11:- INCOME TAXES (Cont.)

2. Tax rates:

On July 25, 2005, the Knesset approved the Law of 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 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%.

In July 2009, the Knesset passed the Law for Economic Efficiency (Amended Legislation for Implementing the Economic Plan for 2009 and 2010), 2009, which prescribes, among others, an additional gradual reduction in the rates of the Israeli corporate tax and real capital gains tax starting 2011 to the following tax rates: 2011 - 24%, 2012 - 23%, 2013 - 22%, 2014 - 21%, 2015 - 20%, 2016 and thereafter - 18%.

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.

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.

NOTE 11:- INCOME TAXES (Cont.)

Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Law so that companies no longer require Investment Center approval in order to qualify for tax benefits. 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 thereunder and the letters 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.

In December, 2007, the Company applied to the Israeli tax authorities for approval of a new "Beneficiary Enterprise" status and requested the year 2007 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 2003.

c. Net operating carryforward losses:

The Company has accumulated losses for tax purposes as of December 31, 2009, in the amount of approximately \$ 8,774 which may be carried forward and offset against taxable income in the future for an indefinite period.

The carryforward losses of the Israeli subsidiary, amounts to approximately \$ 1,130.

NOTE 11:- INCOME TAXES (Cont.)

Foreign:

The carryforward losses of the French subsidiary, amounting to approximately \$ 15,341 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 \$ 11,125 as of December 31, 2009,. 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 \$ 9,070 as of December 31, 2009. The majority of these carryforward losses can be utilized indefinitely.

d. 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:

| | December 31, | |
|------------------------|---------------------|-----------------|
| | 2009 | 2008 |
| Carryforwards tax loss | \$ 13,628 | \$ 13,005 |
| Valuation allowance | <u>(13,115)</u> | <u>(12,623)</u> |
| Net deferred tax asset | <u>\$ 513</u> | <u>\$ 382</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.

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

In 2009, 2008 and 2007, 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:

| | Year ended December 31, | | |
|----------|--------------------------------|------------------|------------------|
| | 2009 | 2008 | 2007 |
| Europe | \$ 11,342 | \$ 15,464 | \$ 12,913 |
| Asia | 6,424 | 5,784 | 3,465 |
| Americas | 8,860 | 8,749 | 5,496 |
| Other | 241 | 1,891 | 1,066 |
| | <u>\$ 26,867</u> | <u>\$ 31,888</u> | <u>\$ 22,940</u> |

- b. Long-lived assets by geographic region:

| | December 31, | |
|----------|---------------------|-----------------|
| | 2009 | 2008 |
| Israel | \$ 1,205 | \$ 1,677 |
| Europe | 171 | 154 |
| Americas | 31 | 65 |
| Other | 35 | 53 |
| | <u>\$ 1,442</u> | <u>\$ 1,949</u> |

NOTE 13:- FINANCIAL INCOME (EXPENSES), NET

| | Year ended December 31, | | |
|---|--------------------------------|-----------------|---------------|
| | 2009 | 2008 | 2007 |
| Financial income: | | | |
| Foreign currency translation adjustments, net | \$ - | \$ - | \$ 295 |
| Interest on bank deposits, net | 56 | 158 | 402 |
| | <u>56</u> | <u>158</u> | <u>697</u> |
| Financial expenses: | | | |
| Foreign currency transaction adjustments, net | (209) | (326) | - |
| Bank charges | (70) | (89) | (124) |
| | <u>(279)</u> | <u>(415)</u> | <u>(124)</u> |
| | <u>\$ (223)</u> | <u>\$ (257)</u> | <u>\$ 573</u> |
